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ABSTRACT

This report presents relevant policy research, historical perspective, and an agenda of major issues involved in the complex process of reauthorizing the Higher Education Act (HEA). Like many other federal laws, the HEA is not permanent. It expires on September 30, 2004, and this expiration requires that the 108th Congress consider extending or reauthorizing the HEA in 2003-2004, its 8th reauthorization. In addition to providing information about the HEA and its historical context, the report suggests an agenda of major policy issues for the HEA reauthorization and options for dealing with these issues. The chapters are: (1) "People Like Us Don't Go to College: Social and Cultural Barriers to Higher Education Access and Persistence" (Jamie Merisotis and Christina Redmond); (2) "No Grades, No Admission: Academic Barriers in Higher Education Access and Persistence" (Melissa Clinedinst); (3) "I Can't Afford To Go to College: Financial Barriers to Higher Education Access and Persistence-Grants" (Alisa Cunningham); (4) "I Can't Afford To Go to College: Financial Barriers to Higher Education Access and Persistence-Loans" (Thomas Wolanin); (5) "How Do Student Financial Aid and Tax Policy Fit Together? Relating HEA Programs to Education Tax Breaks (Need Analysis)" (Matt Hamill); (6) "Where Can I Sit? The Capacity of Higher Education To Provide Access (Construction, Distance Education, Students with Disabilities)" (Ron Phipps); (7) "Why Do Colleges Prices Go Up So Much? Accountability for College Prices" (Alisa Cunningham); (8) "Do Federal Spending and Regulation Produce 'Quality' Higher Education? The Federal Role in Accountability for Quality in Higher Education" (Jane Wellman); (9) "Is Higher Education Needlessly Bound in Red Tape? Regulatory Burden" (Thomas Wolanin); and (10) "Can the HEA Respond to New Priorities? Serving National Needs through the Higher Education Act (Title VI, FIPSE, Graduate Programs, Pubic Service)" (Thomas Wolanin). Two appendixes list attendees at seminars to draft this report. Each chapter contains references. (Contains 18 figures.) (SLD)

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ED 475 429

HEA

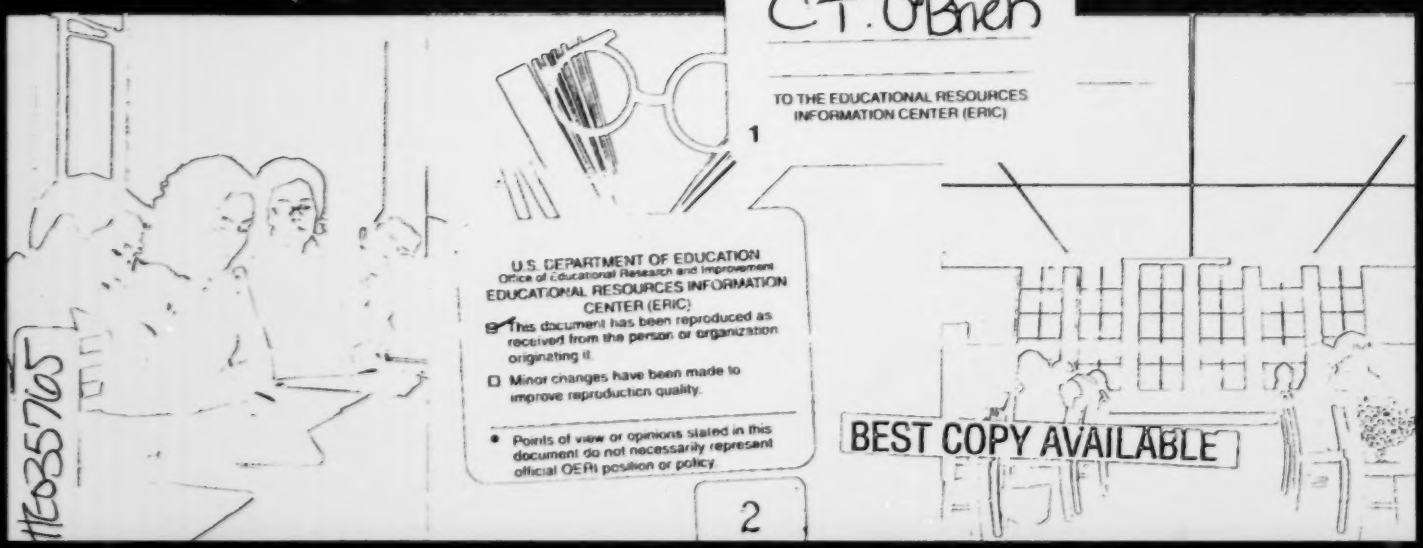
Reauthorizing the Higher Education Act

Issues and Options

Thomas R. Wolanin, Editor

Contributing Authors: Melissa E. Clinedinst • Alisa F. Cunningham • Matthew W. Hamill • Jamie P. Merisotis
Ronald A. Phipps • Christina Redmond • Jane V. Wellman • Thomas R. Wolanin

Prepared by
The Institute for Higher Education Policy



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March 2003

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For further information, please contact:
The Institute for Higher Education Policy
1320 19th Street, NW, Suite 400
Washington, DC 20036
Phone: 202-861-8223
Facsimile: 202-861-9307
Internet: www.ihep.org

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Acknowledgements

The goal of this report is to present relevant policy research, historical perspective, and an agenda of major issues involved in the complex process of reauthorizing the Higher Education Act. Thomas Wolanin, a Senior Associate at the Institute for Higher Education Policy, served as the Project Director for this 18-month initiative and editor of this final report. In addition to planning and editing the volume, he drafted the Introduction and Chapters 4, 9, and 10. The remaining chapters were drafted by other staff at the Institute, specifically: President Jamie Merisotis and Research Associate Christina Redmond (Chapter 1), Research Analyst Melissa Clinedinst (Chapter 2), Director of Research Alisa Cunningham (Chapters 3 and 7), Senior Associate Matt Hamill (Chapter 5), Senior Associate Ron Phipps (Chapter 6), and Senior Associate Jane Wellman (Chapter 8).

As described in the Introduction, identifying the topics to be considered in this report and refining the draft chapters relied heavily on input from knowledgeable members of the higher education community through a series of seminars. The Institute is extremely grateful for the thoughtful, sophisticated, and valuable contributions it received from colleagues who participated in these seminars and who are listed in Appendices 1 and 2. However, it is important to note that this report is solely an Institute product for which these generous colleagues bear no responsibility. Their participation in the seminars should not be construed to indicate their approval of any of the analysis or policy discussions.

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Introduction

The Higher Education Act of 1965 (HEA), like many other federal laws, is not permanent. The current authorization of the HEA will end, and the HEA will expire, on September 30, 2004. This impending expiration requires that the 108th Congress consider extending, or "reauthorizing," the HEA in 2003–04. This would be the eighth HEA reauthorization; previous reauthorizations occurred in 1968, 1972, 1976, 1980, 1986, 1992, and 1998. Each reauthorization offers Congress, the Department of Education (ED), and the higher education community an opportunity to reexamine the purposes of the Act and the programs that serve those purposes.

The goal of this report is to contribute in three ways to the quality and success of the HEA reauthorization. First, the report provides information about the HEA, its programs, and American higher education in general. Second, it offers some historical context for understanding the origins and purposes of the programs created by the HEA. Third, and perhaps most important, it suggests an agenda of major policy issues for the HEA reauthorization and options for dealing with these issues.

The Approach and the Process

Many aspects of the HEA – for example, the loan programs, need analysis, and program integrity provisions – are very complex. This report explains the programs and provisions of the HEA in sufficient detail to support a discussion of the major policy goals of the Act and the options for change. The report is not, however, intended to be an encyclopedia of the HEA, providing detailed and comprehensive technical information about each program and provision of the HEA. Such information is available to policymakers from the Congressional Research Service of the Library of Congress, the Department of Education, and organizations that represent various categories of higher education institutions and administrators, such as the American Council on Education (nonprofit institutions), the National Association of Student Financial Aid Administrators, and the Council for Opportunity in Education (i.e., the "TRIO" programs). Detailed information is also available from government agencies such as the Advisory Committee on Student Financial Assistance and the General Accounting Office (GAO) and from independent think tanks, including the Institute for Higher Education Policy.

The report attempts to be clear and straightforward. Essential data are presented without jargon. There are no footnotes or citations; however, a list of Selected Resources appears at the end of each chapter.

A two-part process was established to help define the major policy topics that are the subject of the ten chapters of the report as well as to identify specific issues of concern, proposals, and options for change.

First, in November 2001, a group of nearly forty experts with extensive experience and knowledge in federal higher education policy, American higher education, the HEA, and related matters was invited to participate in a one-day, off-the-record seminar in Washington, DC, to discuss the HEA reauthorization. (A list of attendees may be found in Appendix 1.) In preparation for this meeting, each participant was asked to produce a "one-pager" briefly outlining the five issues that he or she *expected* to be the most important considerations associated with the HEA reauthorization as well as the five issues that he or she believed *should* be the focus of the reauthorization. The subjects for the ten chapters were formulated on the basis of these one-page summaries, the daylong discussion at the seminar, informal talks with other knowledgeable persons who were unable to attend the seminar, published commentaries about the HEA reauthorization, internal conversations among the staff of the Institute, and the experience and judgment of the editor.

The second step in the process entailed circulating a review copy of the first draft of each chapter to seven to twenty persons knowledgeable about the subject of the chapter. This group was assembled for a half-day seminar at which their comments were discussed with the Institute staff. (The names of those who attended these seminars are listed in Appendix 2.) Each chapter was revised on the basis of this input as well as through internal Institute review.

An Incremental Reauthorization

The title of a publication that appeared before the 1992 HEA reauthorization posed an apt question: *Radical Reform or Incremental Change?* The basic premise of this report is that the HEA reauthorization in the 108th Congress will be incremental policymaking. In other words, the current goals and purposes of the HEA and the major programs to achieve those purposes are likely to continue. The focus will be on modifications and refinements to these existing purposes and programs.

There are six reasons why this is most likely to be an incremental reauthorization:

First, an intellectual foundation for major changes to the HEA has not been established. There has been no national commission report, no landmark study, no best-selling book painting a dramatic and persuasive picture of the need to change the federal higher education policies embodied in the HEA. Before major changes in policy occur, the new ideas and approaches that underlie them must usually circulate and marinate for some time in the public mind and among those in higher education who care about federal policy. As of this moment, no major new ideas have achieved this kind of broad currency. Therefore, largely by default, attention will focus on relatively modest changes to the status quo.

Second, a political foundation has not been laid for major changes to the HEA. There is no public perception of a "crisis" in higher education to which the HEA could respond. President

George W. Bush, as the nation's agenda setter, has not featured higher education issues in his State of the Union addresses, budget recommendations, or other pronouncements. The Republican Party, the Democratic Party, and their national spokespersons have not been highlighting higher education issues. Since higher education has not been a focus of attention for the public or the nation's political leaders in recent years, it is unlikely that these leaders will suddenly discover that it is a national priority demanding major policy initiatives and changes as the HEA reauthorization process proceeds.

Third, national priorities other than higher education policy are clearly dominating the national agenda. These include the war on terrorism, homeland security, disarming Iraq, reforming health care financing, and stimulating economic growth.

Fourth, to the extent that education is a federal policy priority, elementary and secondary education, not higher education, is the dominant concern. The mantra of the Department of Education in the Bush administration is "No Child Left Behind." This suggests that higher education, which does not serve children, scarcely appears on the administration's policy radar screen. During the 108th Congress, substantial attention will be devoted to implementing the reauthorization of the 2000 Elementary and Secondary Education Act, titled the No Child Left Behind Act. In addition, the Individuals with Disabilities Education Act (IDEA) and the Carl D. Perkins Vocational and Applied Technology Education Act are slated to be reauthorized in the 108th Congress. In the usual progression of reauthorizations, both of these acts should have been reauthorized in the 107th Congress. They may therefore be considered to be ahead of the HEA on the congressional education queue. Thus, there may not be enough time or energy in the congressional education committees to undertake comprehensive change.

Fifth, the budget cabinet is bare. Federal surpluses have been replaced by deficits. Budgetary stringency tends to narrow the horizon of policy proposals and actions. The current fiscal situation clearly militates against radical changes in the HEA and in favor of incremental change.

Sixth, the 2002 midterm election placed political control of both houses of Congress, as well as the executive branch, in Republican hands. The reauthorization of the HEA in the 108th Congress will be the first to take place under a Republican presidency and a Republican-controlled Congress. The Democrats enjoyed this level of political control during the HEA reauthorizations in 1968 and 1980. All the other HEA reauthorizations have occurred under some form of divided government, with control of the houses of Congress and the presidency split in various ways. Up to now, these divisions in partisan control do not appear to have been a decisive influence on the direction of the HEA reauthorizations. Of perhaps more consequence is that the 2002 election continued to leave both chambers of Congress closely divided between Democrats and Republicans. This close balance of partisan political power also argues against major changes in policy in any realm, including higher education. Major policy changes are more likely when a broad consensus can be formed in the Congress. Such a consensus is unlikely when the major parties are struggling for small but crucial margins of advantage.

The fact that the HEA reauthorization is likely to be incremental does not mean that it will be unimportant. Changes of any sort, no matter how small, may be positive or negative. Thus, the reauthorization may take policy in a positive direction, by expanding access to higher education for those who would not otherwise attend or by decreasing unnecessary regulatory burdens on colleges and universities. On the other hand, the reauthorization may mark an incremental move in a negative direction, by narrowing access to higher education or increasing regulatory burdens.

Even small changes in the HEA can have major consequences for students, institutions of higher education, or lenders. For example, minor changes from the point of view of the overall policy in need analysis or the definition of an "independent student" could cause changes in eligibility for federal financial aid for hundreds of thousands, or even millions, of students. Similarly, changes in the student loan programs that do not modify basic policies could cause shifts of tens or hundreds of millions of dollars in revenue among lenders or other loan program players. Thus, a HEA reauthorization that is incremental is not the same thing as one that is simple or non-controversial.

Issues for HEA Reauthorization

There is a general consensus that the central purpose of the HEA is, in the words of one longtime observer, "to help people go to college." Given this broad assumption, it is not surprising that six of the ten issues for this HEA reauthorization that were identified through the process outlined above deal with overcoming various barriers to access to higher education. The central policy goal of the HEA is to broaden access to higher education, not only in terms of initial enrollment but also in terms of successful completion of a degree or certificate program. The HEA, in brief, is mostly about getting people into and through higher education. A second objective is to enhance and improve the quality of American higher education. Simply put, the HEA aims to broaden opportunities for quality higher education. This report proceeds from the premise that this is not only the goal of the HEA but also that it is a legitimate and attainable goal for federal policy. Providing quality higher education opportunities for those who would not otherwise have such opportunities serves the public interest. It is also the right thing to do because it helps make this a more fair, just, and equitable society.

The major policy topics for this HEA reauthorization that are addressed in the ten chapters of this report are as follows:

Chapter 1. Many students with the ability to benefit from higher education do not understand and or act on the fact that higher education may be for them. How can the HEA help overcome these *social and cultural barriers* to access?

Chapter 2. Many students with the ability to benefit from higher education do not receive the preparation in K–12 to make them academically qualified for higher education or do not receive the academic support they need to complete their higher education program. How can the HEA help overcome these *academic barriers* to access?

Chapter 3. Many students who want to attend an institution of higher education and are academically qualified to do so lack the ability to pay for higher education. How can the HEA overcome these *financial barriers* to access? In particular, how can grant assistance be most effectively used to overcome these barriers?

Chapter 4. How can *student loan programs* be most effectively used to overcome these financial barriers to access?

Chapter 5. The need analysis system for determining the expected contributions toward college costs from students and their families treats tax benefits for higher education in various and inconsistent ways. How should and can need analysis take into account recent changes in *tax policy*?

Chapter 6. It is projected that higher education institutions will lack *sufficient capacity* to meet the demand for higher education and to make access a reality for all. This topic encompasses support through the HEA for facilities construction, for distance education, and for mechanisms to ensure appropriate accommodation for students with disabilities.

Chapter 7. Why does *college cost* as much as it does, particularly from the point of view of students and their families? Is there an appropriate role for the federal government in dealing with college prices? Are there effective federal policy tools for dealing with these prices?

Chapter 8. Are colleges and universities being held appropriately accountable for the *quality* of their activities, particularly in light of the public funds that they receive? Is there an appropriate federal role in ensuring the quality of higher education? Are there effective federal policy tools for dealing with quality in higher education?

Chapter 9. What is the scope of the federal *regulatory burden* on colleges and universities? What role does the HEA have in both causing and remedying that burden?

Chapter 10. How can the HEA be used to help institutions of higher education effectively serve *new and continuing national priorities*?

The discussion of each of these issues will generally follow a common outline or template that includes the following:

- Background and context of the issue;
- How the HEA currently addresses the issue;
- Limitations or problems in current HEA treatment of the issue; and
- Options and trade-offs involved in changing the HEA with respect to the issue.

The working assumption of this report is that there are no unambiguously "right" or guaranteed successful policies. There are no silver bullets. There are only choices that appear better or worse, given the goals of the policymaker.

Many of the options to make the HEA more effectively meet its goals are likely to require increased federal spending. Many public policymakers, however, believe that restraining federal spending is more important than improving the results produced by the HEA. Still others believe that any additional federal spending should be directed at other more important priorities. These are legitimate policy concerns. Every increase in federal spending requires fiscal and budgetary trade-offs. The U.S. Treasury is not boundless, and choices must be made. To avoid repetition, the general trade-offs involved in increased federal spending are not reiterated as part of the discussion of each option entailing new spending. They should, however, be borne in mind for this entire report.

It is important to note that the relationship between the federal government and higher education began long before the HEA was enacted and extends far beyond the scope of the HEA. For example, in 1819, the Supreme Court case of *Trustees of Dartmouth College v. Woodward* established the independence from direct government control of private higher education (and, indeed, all higher education). In 1862 and 1890, the Land-Grant College Acts accelerated the growth of public higher education in all the states and explicitly linked higher education to national economic development. The G.I. Bill (1944) democratized and "massified" higher education and laid the foundation for a broad middle-class nation. In 1945, a report to the President entitled *Science, The Endless Frontier,* pointed the direction for a permanent federal role in supporting basic research at colleges and universities. The Civil Rights Act of 1964 effectively broke the back of de jure segregation in higher education.

With its emphasis on broadening opportunity and improving quality, the Higher Education Act (1965) added an important dimension to the relationship between the federal government and higher education. But, as the historical record suggests, making the federal government's relationship with higher education work well through the HEA, while extremely important, would not serve as a comprehensive or exhaustive remedy for all the problems, strains, or difficulties in that very complex and extensive relationship.

Some Basic Realities of American Higher Education

In the chapters that follow, each of the reauthorization issues will be introduced by a discussion of its background and context. However, it might be useful to begin by taking a broad look at some of the basic realities of American higher education today. Some of this information may not be totally in line with common preconceptions.

Students

- Fifteen million students are enrolled in higher education.
- Forty-eight percent of undergraduate students are "dependent" on their parents for support.
- All graduate students are, by legislative definition, "independent" of parental support.
- Seventy-five percent of undergraduate students are "nontraditional," meaning that they

have one or more of the following characteristics: not a high school graduate; did not enroll in an institution of higher education directly after high school; are attending part-time; are working full-time; or are financially independent, married, or have dependents.

- Conversely, 25 percent of undergraduate students are "traditional," meaning that they enrolled in an institution of higher education directly after high school; are attending full-time; are working part-time or not at all; and are financially dependent and unmarried without dependents.
- About 10 percent of undergraduate students are "typical" students, i.e., they have all the characteristics of traditional students and also attend a four-year college, and reside on campus.
- About 7 percent of undergraduate students are typical students at a private four-year college or university. It is interesting to note that six of the last nine U.S. Presidents (Kennedy, Nixon, Reagan, George H. W. Bush, Clinton, and George W. Bush) came from this small segment of American higher education.
- Seventy-six percent of students attend public institutions of higher education.
- Sixty percent of first-year undergraduate students (freshmen) attend either a community college (52 percent) or a proprietary school (8 percent).
- About 5 percent of undergraduates attend a "selective" college or university (i.e., one that accepts less than half of those who apply).
- Nine percent of first-year undergraduate students (freshmen) report having a disability, most commonly a learning disability.
- Nearly 40 percent of all students receive financial aid from one or more of the federal programs.
- Approximately 10.5 million *Free Applications for Federal Student Aid* were filed for the 2000–01 academic year by students seeking federal financial assistance.
- During their undergraduate years more than 60 percent of students attend more than one institution of higher education.
- If current trends continue, the nation will face a deficit of approximately 12 million workers with at least some college education by 2020.

Institutions

- Approximately 6,400 institutions of higher education in the United States are eligible to have their students receive federal financial assistance. These institutions, sometimes referred to as "Title IV-eligible institutions," are the universe of institutions directly dealt with by the HEA.
- About 2,100 of these institutions are public (76 percent of all students), including 600 four-year institutions (39 percent of all students) and 1,500 two-year institutions (37 percent of all students).

- About 2,000 of these institutions are private (not-for-profit), including 1,500 four-year institutions (20 percent of all students) and 500 two-year institutions (1 percent of all students).
- About 2,300 of these institutions (4 percent of all students) are proprietary (i.e., private for-profit).
- About 150 institutions of higher education have selective undergraduate admissions (i.e., accept less than half of those who apply).
- More than 40 percent of faculty at nonprofit institutions of higher education are part-time employees.

"People like us don't go to college."

Social and cultural barriers to higher education access and persistence

Background

Programs to increase access to and persistence in higher education are the central focus of the HEA. This chapter discusses the specific ways in which social and cultural barriers affect access and persistence. These social and cultural barriers are nonfinancial and nonacademic barriers such as students' attitudes and motivation and their understanding of what higher education entails. This chapter examines the various strategies that the HEA offers to address the social and cultural barriers to college access, the limitations of these strategies, and the options and trade-offs for addressing them during the HEA reauthorization. This chapter also describes the opportunity gap, the broad trends related to the participation of low-income and minority students in higher education, and factors such as income, race, and educational aspirations, which are typically associated with barriers to access for these populations.

The Opportunity Gap

The number of students participating in postsecondary education immediately after high school graduation has increased in the past thirty years. This increase has occurred across income levels and racial groups. For example, in 1998 almost half of all low-income students enrolled in college upon graduating from high school; the percentage was twice as high as it had been in 1972. Blacks and Hispanics have experienced similar increases in college-going rates.

Despite these encouraging trends, comparisons between college participation rates of students in the lowest and highest income groups and between minorities and Whites reveal that longstanding gaps with regard to higher education opportunities have not diminished dramatically in the last three decades. For example, Census data indicate that there is still a wide difference in college participation based on family income. In 2000, there was a difference of nearly 30 percentage points between low-income and high-income high school completers who were enrolled in college the October after graduating from high school.[1] This gap has narrowed only 10 percentage points in the last thirty years. Furthermore, racial/ethnic differences in the percentages of high school completers who were enrolled in college the October after graduating from high school

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1 "Low-income" is defined as the bottom 20 percent of all family incomes; and "high-income " is the top 20 percent of all family incomes.

have actually increased during the past thirty years. In 2000, the gap between Whites and Blacks was 11 percentage points; in 1972, the gap was only 5 percentage points. Between Hispanics and Whites, a 13 percentage point difference existed in 2000, compared with a 5 percentage point gap almost thirty years earlier.

The challenges associated with closing the opportunity gap faced by minorities and low-income students become even more daunting in light of projections of the size of the college-age population by 2015. Between 2000 and 2015, the college-age population is projected to increase by 2.6 million, a 16 percent increase. Of this group, 80 percent are expected to be nonmajority, and nearly half will be Hispanic. A larger portion of the future student pool served by the college and university system will be nonmajority – a group that historically has encountered obstacles toward degree attainment. Policy steps will need to be taken to improve low-income and minority students' attendance and graduation rates if this country is to meet its future workforce needs. This opportunity gap can be attributed to many factors, including inadequate academic programs and preparation at the K–12 level, a lack of financial resources to pay for college, and a lack of sufficient places in higher education to accommodate all qualified students. These topics are discussed in Chapters 2 through 6.

Social and Cultural Barriers

Social and cultural barriers can limit access to and persistence in higher education. These barriers include attitudes and perceptions that low-income and minority students carry with them that may prevent able students from aspiring to higher education or that undermine their motivation to take advantage of opportunities for higher education. For example, in some groups, male children are more actively encouraged to pursue higher education than female children. Students and their parents also may not understand what is required to gain access to and succeed in higher education, or may not receive timely and comprehensible information about higher education options. These social and cultural barriers are linked to factors such as parental education attainment, first-generation status, family income, race, limited English proficiency (LEP), and, in some cases, welfare and undocumented status.

Low family income tends to exacerbate social and cultural factors such as parent's education, first-generation status, race, language proficiency, and disability. National data show that family income influences students' college plans. Students from higher income households ($45,000 and above) comprise the highest percentage of those planning to attend a four-year institution, and students from the lowest income bracket (below $15,000) comprise the smallest percentage of this aspiring-to-college population. According to a recent report of the federal Advisory Committee on Student Financial Assistance (ACSFA), among "college-qualified" low-income high school graduates, only 70 percent expected as eighth graders to finish college, compared with 95 percent of high-income high school graduates. Only 21 percent of "college-qualified" low-income high school graduates, compared with more than 60 percent of the high-income "college-qualified" population, complete a bachelor's degree.

Across all groups, parental educational attainment appears to directly influence students' college aspirations and actual college plans. Students whose parents have a college degree tend to aspire to go to college and actualize these plans at higher rates than do students whose parents lack such a degree. For example, approximately 85 percent of students whose parents earned a college degree or higher aspired to go to college in the ninth grade, compared with about 59 percent of students with parents who had received some high school education. Furthermore, many of the students with parents with lower levels of education do not follow through on their plans to go to college. Only one-fifth of students whose parents had no more than some high school education actually made plans to attend college (e.g., took a college entrance exam or filled out an application), compared with almost three-quarters of students whose parents held a college degree or higher.

Students who are the first in their family to attend college (i.e., "first-generation" students) typically lack general knowledge about postsecondary education as well as specific information about the admissions and financial aid process. First-generation students comprised 40 percent of all undergraduate students in 1999–2000. In comparison to students whose parents have been exposed to postsecondary education, first-generation students also generally are less academically prepared to go to college, take fewer college preparatory courses, and fail to take college entrance exams.

For children of recent immigrants, who may have difficulty speaking English or lack an understanding of the United States higher education system, the challenges associated with being first-generation are compounded. For example, a recent study found that Latino parents have little knowledge about higher education and often do not adequately inform their children about the advantages of taking college preparatory and Advanced Placement courses, the benefits of going to college, and career paths available only to those with college degrees. These parents are also unable to provide basic information to their children about how to negotiate the admissions and financial aid process.

In addition, LEP students themselves face difficulties in attaining the academic preparation necessary for accessing postsecondary education. Many LEP students come from low-income families, are not adequately prepared academically in their home country or in the United States, and have high rates of illiteracy and low levels of parental educational attainment. If LEP students do enroll in postsecondary education and are required to take English as a Second Language (ESL/ESOL) courses, these courses generally are not credit-bearing, thereby increasing the time required to complete a degree and possibly draining the families' financial aid resources and the students' patience.

Other subgroups of special concern are undocumented students (sometimes called "undocumented persons" or "illegal immigrants")[2] and welfare recipients. Federal law

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[2] In general, according to the Immigration and Naturalization Service (INS), a "nonimmigrant" is a person who has attempted to enter the United States without permission from the INS. More specifically, the INS defines illegal aliens or illegal immigrants as those "not in possession of a passport valid for a minimum of six months from the date of the expiration of the initial period of the alien's admission or contemplated initial period of stay" and who is "not in possession of a valid nonimmigrant visa or border crossing identification card at the time of application for admission."

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provides that undocumented children cannot be excluded from attending elementary and secondary public schools in the United States. However, some states prohibit undocumented students who have graduated from high school from receiving in-state tuition rates or state student aid. Federal law requires that if a benefit is offered to undocumented individuals, it must be offered to all citizens. This law can be construed to require that states that offer in-state tuition rates to undocumented students must offer in-state tuition to everyone. This federal policy may be driving some of the state policies that deny in-state tuition or financial aid to undocumented students. States such as Texas and California recently have developed policies to assist some illegal aliens who graduate from a high school in the state by offering in-state tuition or eligibility for state student assistance. These states base their determinations regarding eligibility for in-state tuition and financial aid on the length of time the student has resided in the state, rather than their undocumented status.

Currently, undocumented students are not eligible to receive federal student aid. Legislation was introduced in the 107th Congress to modify this policy. For example, H.R. 1582 would allow undocumented students who entered the United States before turning sixteen years of age and who have lived in the country for at least five consecutive years before the age of twenty-five, to be granted permanent resident status. These students would thus become eligible for federal financial aid since permanent residents are defined as among those eligible to receive federal aid under the HEA. Similar legislation has been introduced in the 108th Congress.

Some welfare recipients are allowed to pursue educational opportunities as partial fulfillment of their work requirements. In 1996, Temporary Assistance for Needy Families (TANF) replaced the Aid to Families with Dependent Children and Job Opportunities and Basic Skills Training programs. The new law provided that no more than 30 percent of a state's TANF participants can fulfill their work requirement by taking part in educational activities. Educational activities as a form of "work" include work experience, on-the-job training, vocational education, or job skills training directly related to employment for a maximum of 12 months. In 2002, the Bush administration proposed cutting the maximum amount of time that welfare recipients can pursue educational endeavors from one year to four months every two years. In addition, welfare recipients would be required to work at their jobs for forty hours each week (the current requirement is thirty hours), which would limit their opportunities for postsecondary education. These issues will be addressed in the 108th Congress during the consideration of the TANF reauthorization.

HEA Strategies for Addressing Social and Cultural Barriers

The HEA funds programs and initiatives aimed at mitigating social and cultural barriers to higher education access and completion faced by educationally and economically disadvantaged students. Some of these programs – in particular, TRIO and the Gaining Early Awareness and Readiness Undergraduate Programs (GEAR UP) – target students beginning in middle school, through high school, and into postsecondary education. In addition, the High School Equivalency Program (HEP) and the College Assistance Migrant Program (CAMP) focus on assisting migrant and seasonal farm workers in

achieving a high school diploma and entering postsecondary education. These programs are collectively known as "early intervention" or "early outreach" programs.

TRIO. The first of the TRIO programs (Upward Bound) was launched in 1964 under the Educational Opportunity Act and focused on educational opportunities for low-income students who were the target of the federal War on Poverty. In subsequent years, the TRIO programs were expanded to include six outreach and support programs – Talent Search, Upward Bound, Student Support Services, The Ronald McNair Post-Baccalaureate Achievement Program, the Educational Opportunity Centers Program, and Staff Developmental Activities. Two of the TRIO programs, Talent Search and Upward Bound, serve precollege students who come from low-income families and whose parents have not attended college. Through the Talent Search program, participants – ranging in age from eleven to twenty-seven – receive information about college admissions, scholarships, and financial aid programs, and academics, advising, counseling, and tutoring. The Upward Bound program assists students ages thirteen to nineteen in preparing for college by providing academic instruction on college campuses, as well as counseling, mentoring, and other support services. Educational Opportunity Centers (EOCs) provide financial aid information, college counseling, and assistance in applying and entering postsecondary education. These centers serve students who are at least nineteen years of age, the majority of whom are low-income or first-generation students, as well as displaced or underemployed workers. Student Support Services (SSS) help students remain in college until completion of their degree or program by providing tutoring, counseling, and remedial instruction.

More than 1,900 TRIO projects currently serve nearly 700,000 low-income, first-generation students between the ages of eleven and twenty-seven. In fiscal year (FY) 2001, 360 Talent Search grants were awarded. The average award was $305,446, and total appropriations were approximately $110 million. Upward Bound grants totaled 895, with an average award of $315,086 and total appropriations of approximately $282 million. The number of EOC grants was eighty-three; the average award was $405,296, and total appropriations were approximately $33 million. Finally, 944 SSS grants were provided, with an average award of $270,013 and total appropriations of approximately $255 million. The law requires that at least two-thirds of TRIO participants be from homes with family incomes below $24,000 and where neither parent graduated from college. Thirty-nine percent of students in the TRIO programs are White, 36 percent are African American, 16 percent are Hispanic, 5 percent are Native American, and 4 percent are Asian American.

GEAR UP. In the 1998 HEA reauthorization, GEAR UP was enacted to build on earlier federal and private initiatives that provided assistance to precollege students. GEAR UP projects aim to provide comprehensive mentoring, counseling, and support services to entire cohorts of low-income students in a school. Assistance begins no later than seventh grade and continues through high school graduation. In addition, the projects provide early information about college financing options and a guarantee of financial assistance to pay college bills. GEAR UP grants are available either to partnerships or states and require a dollar-for-dollar match that can be satisfied by cash or in-kind contributions. Partnership grants are awarded to partnerships of local educational

agencies, middle schools and high schools, higher educational institutions, businesses, and community organizations. State grants awarded under GEAR UP allow the governor of that state to designate who will administer the GEAR UP grant – typically state higher education agencies or universities, state departments of education, student financial assistance agencies, or governors' offices. In contrast to the partnership grants, state GEAR UP projects are not required to serve cohorts of students. GEAR UP provides seed money and a demonstration program with the expectation that state and partnership efforts will continue after federal support has expired. The TRIO programs, on the other hand, are built on the assumption of continuity of federal support and of services to eligible students before and during college.

Key components of GEAR UP include early information about financial aid as well as college scholarships. Its 21st Century Scholars Certificate provides notification to low-income students in grades six through twelve of their eligibility for a federal Pell Grant. GEAR UP scholarships are awarded to students who are less than twenty-two years old, have received a high school diploma or its recognized equivalent (i.e., a general equivalency diploma [GED]), have participated in a GEAR UP or TRIO program, and are enrolled in or accepted for enrollment at an institution of higher education. In sum, the GEAR UP model links early intervention services for student cohorts with early knowledge about financial aid and some certainty of receiving such aid.

The GEAR UP FY 1999 appropriation – the first year of operations – was $120 million. In that year, twenty-one GEAR UP state grants were awarded with an average year-one award of $1,980,373 (awards are generally made for a five-year period), and 164 partnership grants were awarded with an average year-one award of $459,220. In FYs 2000 through 2002, fifteen additional state grants and 124 additional partnership grants were awarded. The GEAR UP FY 2002 appropriation was $285 million. In its first year of operation, the program served nearly 450,000 students nationwide, and it is estimated to have assisted approximately one million students in 2002. Currently, the student population served by GEAR UP is 36 percent Hispanic, 30 percent African American, 26 percent White, 5 percent Native American/Hawaiian, and 3 percent Asian.

HEP/CAMP. HEP originated as a pilot program in the Office of Economic Opportunity to assist low-income migrant and seasonal farm workers in obtaining a GED or the equivalent to a high school diploma. Today, there are fifty-nine programs nationwide. Programs are chosen competitively and are administered through ED. In 1998–99, almost three-quarters of HEP participants completed their GED. In FY 2002, $23 million was appropriated and nearly 9,000 migrant students were served.

CAMP began in 1972 in the Department of Labor and was later transferred to ED. It provides financial and academic support for students who are from migrant and seasonal farm worker families to complete their first year of college. In 1998–99, 88 percent of CAMP students finished their first year of college in "good standing," and more than 70 percent completed their baccalaureate degree. In FY 2002, $15 million was appropriated for forty-two projects chosen competitively. These projects served approximately 2,500 students.

Grant programs are also authorized under the HEA that are aimed at developing and strengthening postsecondary institutions that serve students who face societal barriers, particularly first-generation, low-income, and minority students. These grant programs, operated under Titles III and V of the HEA, provide both formula and competitive grant funding for capacity building at these institutions. Funds are authorized for use for fourteen purposes, including student service programs designed to improve academic quality, endowment building, financial management, faculty development, and infrastructure improvement. Titles III and V of the HEA provide the following types of assistance:

- **Title III, Part A, Section 311**, provides competitive grant funding to institutions with limited resources (i.e., low general and educational expenditures) that serve a high number of low-income students. Institutions under this category are the largest group of Title III grantees. In FY 2002, $73.6 million was appropriated for this section of Part A for fourteen planning grants (one-year duration), averaging $33,000; nineteen new individual developmental grants (five-year duration), averaging $350,000; and 196 continuation awards for existing grants, averaging $350,000.

- **Title III, Part A, Section 316**, provides competitive grant funding to strengthen American Indian Tribally Controlled Colleges and Universities (TCCUs), which were founded to educate American Indians on or near reservation communities and usually are tribally controlled. The first Tribally Controlled College was established in 1968, so most TCCUs are relatively early in their development. In FY 2002, $17.5 million was appropriated for one new individual development grant of $400,000. In addition, twenty-seven continuation grants, averaging $3[illegible]4,000, and six construction grants, averaging $1,208,000, were provided. TCCUs also receive support through the Tribally Controlled College or University Assistance Act (TCCUAA), which is administered by the Interior Department. Funding through this program is based on the number of American Indian students enrolled at an institution, and it provided $3,916 per Indian Student Count (ISC) in FY 2002. Appropriations for the TCCUAA have never reached the authorized level of funding, which is currently $6,000 per American Indian student.

- **Title III, Part A, Section 317**, provides competitive grant funding to Alaska Native and Native Hawaiian-Serving Institutions. This program was created by the 1998 HEA reauthorization. It is aimed at institutions that educate at least 20 percent Alaska Native students or at least 10 percent Native Hawaiian students. In FY 2002, $6.5 million was appropriated for seventeen continuation awards, averaging $382,000.

- **Title III, Part B, Section 323**, provides financial assistance based on a formula to strengthen Historically Black Colleges and Universities (HBCUs). These public and private colleges began operating in the 1860s to help African Americans overcome the legacy of slavery and to provide higher education opportunities to African Americans excluded from predominantly White institutions by de jure or de facto segregation. In FY 2002, $206 million was appropriated for this section of Part B. Awards were made to more than 100 institutions, and the size of the average award was $2.1 million.

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- **Title III, Part B, Section 326**, provides formula funding for specific graduate-level HBCUs named in the law. In FY 2002, $45 million was appropriated for five new development grants, averaging $4.9 million and thirteen continuation awards, averaging $1.9 million.

- **Title III, Part E, Section 1**, the Minority Science and Engineering Improvement Program, provides competitive grants to institutions that serve high numbers of minority students, nonprofit science-oriented organizations, and consortia (e.g., research laboratories and private organizations) to increase the number of minorities, particularly minority women, who are trained for science and engineering careers. In FY 2002, $8.5 million was appropriated for forty-two new awards, averaging $105,000, and for fifty-nine continuation awards, averaging $68,000.

- **Title V** provides competitive grants to Hispanic-Serving Institutions (HSIs) whose undergraduate full-time equivalent (FTE) enrollment is at least 25 percent Hispanic, with 50 percent of its Hispanic student population classified as low-income. In addition, the institution must have low education and general expenditures. In FY 2002, $86 million was appropriated for twenty-one new individual development grants, averaging $402,000; twelve new cooperative arrangement grants, averaging $585,000; and 157 continuation awards, averaging around $500,000.[3]

Collectively, TCCUs, Alaska Native and Native Hawaiian-Serving Institutions, HBCUs, and HSIs are referred to as "minority-serving institutions," or MSIs. MSIs enroll a high proportion of minority students, many of whom come from educationally disadvantaged and low-income backgrounds. Often these students are the first in their family to attend college. The majority of these institutions were established in order to remedy histories of racial and ethnic discrimination and to provide postsecondary training to populations who have experienced a number of obstacles in obtaining a postsecondary education at predominantly White or mainstream institutions. Today, MSIs combined educate 31 percent of all Hispanics, African Americans, and American Indians enrolled in higher education. Enrollments at MSIs are growing more rapidly than enrollments at other institutions, rising 22 percent between 1990 and 2000, compared with an increase of 9 percent at all higher education institutions.

Limitations of Current HEA Programs

Though the programs described above aim to decrease the social and cultural barriers that some students face in accessing higher education, there are limitations in these approaches to providing improved educational opportunities. In recent years, questions have been raised about whether interventions begin early enough in a student's educational career and whether focusing on a cohort of students has increased benefits. There are also concerns about the intensity of the services provided and possible duplication or overlap among programs.

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[3] Cooperative arrangement development grants are similar to individual development grants but must specify an arrangement between two or more eligible higher education institutions that, through a combination of their resources, will carry out allowable grant activities, better achieve program goals, and avoid duplicative costs.

Evaluations have been conducted of Upward Bound and Talent Search. The results were largely inconclusive. Because of their nonlongitudinal focus, the evaluations provided only imperfect snapshots of these programs. The evaluators had difficulty measuring program effectiveness because of differences in target populations, program design, and data collection practices. As a result, the evaluations have not provided a clear portrait of the strengths and weaknesses of the TRIO programs or, more important, how they could be improved. With respect to GEAR UP, the program has been in existence for a short time, and it is too early to evaluate it.

Factors such as family background and income level, peers, and location make it difficult to determine what factors most influence a student's decision to enter a postsecondary program and therefore to assess with scientific precision what exactly works in the various early intervention programs. The best way to link program design and delivery with student choices is not obvious.

Some potential applicants for TRIO funds have felt that the programs "prior experience points" system was unfair because it decreased their chances of receiving a TRIO grant. "Prior experience" means that those institutions that have a TRIO program receive preference points when applications for grant renewal are evaluated. The preference points are program-specific. An institution receives prior experience points only if, for example, it already hosts an Upward Bound program and is reapplying for an Upward Bound grant. The prior experience points would not apply if that institution were applying for another TRIO program, such as Talent Search.

Prior performance is a core concept of the TRIO programs. Having a TRIO program on a campus for an extended period of time makes services for low-income students an integral part of the institution's mission and a permanent part of its student aid program. Prior experience also reflects a basic presumption in favor of continuity of a TRIO program on a campus, much like the presumption in favor of leaving campus-based financial aid programs at institutions that have established such programs. The basic idea is that just as federal financial aid should be available at every institution of higher education, services to aid students at every institution, and in every community, should be available as well. Furthermore, programs with prior performance points develop an experienced group of TRIO professionals who are able to better serve their students and institutions. Recent data from the Council for Opportunity in Education note that while 92 percent of colleges and universities with prior experience were funded in the last four competitions, 34 percent of new applications – colleges without TRIO programs – also were funded over the same period. Over the last three GEAR UP competitions (FY 1999, 2000, 2001), 21 percent of applications requesting a partnership GEAR UP grant and 38 percent of states that applied for a state GEAR UP grant received funding.

Limited funding also restricts the scope and intensity of services provided by these intervention programs. For example, less than 10 percent of eligible populations are actually served by TRIO programs. GEAR UP has a similar funding ratio. The majority of students at Title III and V institutions are from low-income families, Pell Grant recipients,

first-generation students, and members of minority groups. These students need financial and academic counseling, developmental education, and overall support. However, these institutions have faced chronic underfunding, making it difficult for them to meet the needs of student populations that are increasing in number. For example, in 1999, total institutional revenue per student (from all sources) at MSIs was 37 percent lower than the average at all U.S. institutions. Endowment income for these institutions also is significantly less than that at other institutions.

In the 1998 HEA reauthorization, HSIs were moved from Title III to a new Title V, with the goal of better serving the needs of these institutions and their students. The law defines HSIs as institutions that have at least a 25 percent Hispanic undergraduate FTE enrollment – with at least 50 percent of their Hispanic FTE students coming from low-income backgrounds – and low educational and general expenditures. However, some have questioned whether the 25 percent Hispanic enrollment figure indicates that an institution, in fact, has a special commitment or capacity to serve the educational needs of Hispanic students, particularly overcoming social and cultural barriers to opportunity. What is the rationale behind 25 percent? Should the threshold be higher? Lower? What would be a more sophisticated indicator of "serving" Hispanic students? More analysis may be needed to differentiate those institutions that enroll 25 percent or more Hispanic students and commit to equalizing educational opportunities for Hispanics from institutions that might reach the 25 percent threshold but that do not have educating Hispanics as a central part of their mission. HSIs are defined primarily by these enrollment percentages, while HBCUs and TCCUs largely were established for the specific purpose of educating African Americans and American Indians, respectively, and serving the particular needs of the communities that previously had been underserved by mainstream institutions.

Similar questions arise in creating other types of minority-serving institution designations under the HEA. For example, H.R. 4825, introduced in the 107th Congress, would create a new subpart under Title III for institutions serving Asian Americans and Pacific Islanders. To be eligible for funding under this subpart, institutions would need to have an undergraduate enrollment that is at least 10 percent Asian American and Pacific Islander. The problems noted above associated with the HSI enrollment percentage threshold could apply to the Asian American and Pacific Islander-serving designation as well. On the other hand, these problems might be avoided since H.R. 4825 includes a stipulation that eligible institutions be required to have a five-year plan for improving assistance to Asian American and Pacific Islander students, which the Title V legislation does not specify. However, in the proposed legislation, eligible institutions do not need to demonstrate that they serve a specified percentage of Asian Americans and Pacific Islanders who are low-income; all other institutions that currently receive funding under Title III and V, by contrast, must serve a certain percentage of low-income students in their respective populations.

Options and Trade-offs

Several options to address the issues related to social and cultural barriers to higher education are possible under the upcoming HEA reauthorization. These options include the following:

Adjust minimum TRIO grant levels for inflation. As demand for early intervention services (e.g., counseling, enrichment activities) increases, funding to support these programs also is in demand. In 1992, Congress reversed a long history of decreases in the intensity of services that these programs were able to provide to students by establishing minimum grant levels. However, these grant levels may need to be adjusted for inflation. It is not at all certain whether appropriations will increase sufficiently both to pay for the increased minimum grants and to continue to support an increasing number of new projects.

Increase the percentage of SSS funds that can be used for financial aid to students. The 2001 Labor-Health and Human Services-Education Appropriations Act amended the SSS program to allow projects to provide grant aid to SSS students who are also receiving Pell grants. Under this provision, no more than 20 percent of SSS grant funds can be allocated to provide grant aid to students. Proposals have been advanced to raise the maximum allocation of grant funds to 30 percent. Current law stipulates that more funds cannot be allocated for grant aid until the overall allocation for SSS grants doubles. Increased grant funds through SSS might reduce students' unmet financial need and could increase retention rates. On the other hand, the provision of more student financial aid could come at the expense of the academic support services provided under the program. It could dilute the focus of TRIO funding from its primary purpose of overcoming social and cultural barriers for students. Also, to give TRIO professionals responsibility for awarding financial aid is to assign them responsibility in an area in which they lack expertise. Creating yet another source of financial aid also compounds the problem of assembling and coordinating student financial aid packages.

Modify the system of prior experience/performance. The elimination of prior experience points associated with the TRIO programs would not increase the number of low-income and first-generation students served by these programs. It would simply provide those services at a different set of institutions to a different group of low-income and first-generation students. In other words, it would shift services from one needy group of students to another group of needy students. In addition, elimination of prior experience could degrade the quality of services received by students, since well-established programs with experienced staffs could be more easily replaced by new programs and inexperienced staffs.

Increase authorization levels for TRIO, GEAR UP, HEP/CAMP, and Titles III and V. Federal appropriations for these programs historically have not come close to meeting the needs of the target populations. Given demographic projections that show increasing numbers of these populations, increased support will be necessary. While the direct link between appropriations and authorization levels is often limited, higher authorizations can certainly signal support for increased annual appropriations.

Modify the definition of an HSI. Reconsideration of the definition of an HSI may be appropriate to better target Title V support on students at institutions that have made a specific commitment or have a special capacity to serve Hispanic students. Beyond

measuring Hispanic enrollment, indicators could be developed that measure how institutions actually serve Hispanic students. Such indicators could include, for example, the types of programs and services geared toward Hispanic students that are available on campus, or outreach to nearby Hispanic communities or Hispanic members of an institution's board of trustees. In addition, institutions that serve a large Hispanic population could be asked to develop five-year plans aimed at serving Hispanic students in measurable ways, similar to a requirement in the proposed legislation that would assist institutions that serve high percentages of Asian American and Pacific Islander students. Such definitional changes may be complex and may require significant data reporting or other actions that could create added administrative burdens for HSIs. These same considerations would also apply to the creation of other minority-serving institution designations, such as Asian American and Pacific Islander-Serving Institutions.

Develop provisions to serve new populations, including undocumented students. The requirement that all students at the K–12 level have access to a public education independent of their parents' immigration status means that increasing numbers of undocumented students are graduating from high school. Many aspire to attend college and are qualified to do so. A significant number of the students classified as "undocumented" or "illegal" are in this country because of the decisions of their parents. These students were brought to the United States as young children, raising the question of whether they are being unfairly punished for the actions of their parents. One way to address this problem under the HEA would be to adopt the provisions of H.R. 1582, which was introduced in the 107th Congress. It would allow an undocumented student who entered the United States before turning sixteen years of age, who has lived in this country for at least five consecutive years, and who is not more than twenty-five years of age to be granted permanent resident status, thereby making him or her eligible for federal student aid. Some would argue that such a policy would "reward" the illegal behavior of the students or their parents by offering them eligibility for federal financial aid. On the other hand, since almost all of these college-qualified youth are going to remain in the United States, it serves the nation's interests to help make them highly productive workers and sophisticated citizens.

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"No grades, no admission."

Academic barriers to higher education access and persistence

Background

Many studies have documented a substantial gap between the academic performance of students from low-income families and minority students and the performance of other students. Inadequate academic preparation is one of the significant barriers to access to higher education. The principal federal efforts to improve the academic performance of K–12 students are contained in the Elementary and Secondary Education Act of 1965, the 2001 reauthorization of which is titled the No Child Left Behind Act. However, the HEA also includes several programs aimed at helping students overcome academic barriers to postsecondary access.

HEA Programs Addressing Academic Barriers

Several programs in the HEA provide direct educational services to students to augment their regular school programs. The Upward Bound TRIO program, GEAR UP, and HEP all provide supplementary education to low-income, first-generation, and migrant students in middle school and high school. Two of the TRIO programs (SSS and the Ronald E. McNair Postbaccalaureate Achievement Program) as well as CAMP, provide these same categories of students with academic assistance during their collegiate careers. Chapter 1 discussed these programs and options for their improvement during the HEA reauthorization.

The main thrust of the HEA with respect to overcoming academic barriers to access to higher education is found in the programs in Title II that focus on improving teacher training and the quality of the teaching workforce. The HEA addresses this aspect of the quest to improve K–12 education, particularly for low-income and minority students, because institutions of higher education provide most preservice teacher training as well as some teacher professional development.

Research has shown a strong link between teachers' knowledge and skills and students' academic gains. Therefore, the quality of the teaching force is a critical variable in helping all students achieve high academic standards. Given the powerful effect that qualified teachers have on student achievement, the teacher workforce has the potential to exert a strong influence on reducing the current achievement gaps. The No Child Left Behind Act calls for a highly qualified teacher to be in every K–12 classroom by the 2005–06 academic year.

Unfortunately, this country faces an overall shortage of teachers as well as a particularly acute shortage of teachers in critical specialties. As a result of growth in the numbers of school-age

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children, increasing retirement in an aging teaching force, and high turnover among young entrants to the teaching profession, America's schools must hire approximately two million new teachers in the next decade. Shortages in certain subject areas, such as mathematics and science, are particularly critical; as a result, many out-of-field teachers have been hired to fill positions in these classrooms. Teachers trained to educate students with disabilities and LEP students, two very rapidly growing groups, are also in especially short supply. Furthermore, the teaching profession has not kept up with the demographic shifts in the school-age population. In 2000, minorities accounted for nearly 40 percent of public school students; however, in the 1993–94 school year, only about 10 percent of teachers were minorities. This discrepancy has two unfortunate consequences. It fails to provide role models for minority students and, at the same time, does not offer majority students exposure to teachers who represent the country's diversity and changing demographics.

Five programs in Title II are aimed at increasing the numbers of high-quality teachers.

1. **State Grants** provide one-time matching grants to help states improve the quality of their teaching force. Grants are awarded on a competitive basis for three years. Program activities include holding institutions accountable for high-quality teacher preparation, reforming certification and licensure requirements, providing alternatives to traditional preparation for teaching, and establishing alternative routes to state certification. This program was created in the 1998 HEA reauthorization and received its first appropriation, which totaled $33.4 million, for FY 1999. For FY 2002, it received $40.1 million. Thirty-eight grants were made in FY 2001.

2. **Partnership Grants** provide one-time matching grants to partnerships consisting of, at a minimum, an institution of higher education with a high-quality teacher training program, a school of arts and sciences, and a high-need local educational agency. Grants are awarded on a competitive basis for five years. Program activities include reforms to hold teacher-training programs accountable for preparing highly competent teachers, to provide high-quality preservice clinical experience, and to prepare teachers to work with diverse student populations. This program was created in the 1998 HEA reauthorization and received an appropriation of $33.4 million for FY 1999. For FY 2002, it received $40.1 million. Thirty-two grants were made in FY 2001.

3. **Teacher Recruitment Grants** provide one-time grants to states or partnerships eligible for Title II partnership grants to aid in the recruitment of qualified teachers for high-need local educational agencies. Funds are used to provide scholarships for students in teacher preparation programs, support services to enable these students to complete their program, and follow-up services during the first three years in which the scholarship recipients are teaching. Scholarship recipients must teach in a high-need local educational agency for a period of time equal to the period for which they received scholarship assistance. Those who do not do so must repay the amount of the scholarship. "High-need" schools are defined as those in high-poverty areas, with a high percentage of out-of-field high school teachers or a high rate of teacher turnover. This program was created in the 1998 HEA reauthorization and received an appropriation of $9.6 million for FY 1999. For FY 2002, it received $9 million. In FY

2001, twenty-one grants were made. The administration requested no funds for FY 2003 for Teacher Recruitment Grants.

4. **Accountability for Programs that Prepare Teachers** provisions also are provided here. To evaluate progress toward improving teacher preparation and to inform the public on the quality of the teaching force, Title II requires the compilation of three annual report cards. Institutions of higher education that conduct a teacher preparation program must annually provide to their states and to the public information on the pass rates of their graduates on state licensing examinations as well as other program information (e.g., the number of students enrolled, hours of supervised teaching, and faculty/student ratios). Each state must annually provide to the Secretary of Education a report card outlining important state-level information, including state teacher licensure requirements, passing scores on teacher assessments and the percentage of graduates who pass, descriptions of alternative certification procedures and the percentage of teachers who use them, and the extent of waivers of teacher certification requirements by subject area and poverty levels of school districts. The states must also develop procedures for identifying low-performing teacher training schools and methods for assisting these schools. The Secretary of Education compiles the state report cards into an annual report to Congress that compares states' efforts. The first institutional report cards were issued in April 2001, and state report cards were issued in October of that year. The Secretary of Education made his first report to Congress in April 2002.

5. **Preparing Tomorrow's Teachers to Use Technology (PT3).** The No Child Left Behind Act transferred this program from the Elementary and Secondary Act to Title II of HEA in 2001. PT3 provides matching grants on a competitive basis for up to five years. Consortia similar to the partnerships eligible for Title II Partnership Grants are eligible to apply for assistance. The purpose of the grants is to improve the ability of higher education institutions to prepare prospective teachers to use advanced technology in instructing students. Appropriations for the program reached a high of $125 million in FY 2001. For FY 2002, PT3 received $62.5 million; this sum was earmarked solely for continuation awards to current grantees. Believing that this program is duplicative of other efforts, the administration intends to terminate it and requested no funds for it in FY 2003.

Outside of Title II, the Perkins Loan Program has since its beginning in 1958 provided loan cancellations to encourage students to pursue teaching careers in fields where shortages exist or at high-need schools. In the 1998 HEA reauthorization, the Loan Forgiveness for Teachers provisions (Sections 428J and 460) were enacted. This was the first attempt to encourage students to enter and continue in the teaching profession through forgiveness in the Stafford Loan program, which provides the great bulk of loans to students under the HEA. These loan-forgiveness and loan-cancellation programs are discussed in Chapter 4.

Many minority students who complete teacher education programs do so at minority-serving institutions (e.g., HBCUs, HSIs, and TCCUs). More than 40 percent of all teacher education degrees awarded to African Americans, Hispanics, and American Indians are

conferred by these institutions. The demographic representativeness of the American teaching force, as well as the number of high-quality teachers, could be improved by strengthening the HEA programs in Titles III and V that support these institutions. The HEA programs for MSIs and options for their improvement during the reauthorization are discussed Chapter 1. Because of the important role that they play in teacher education, MSIs could be given a priority for Title II grants in the HEA reauthorization.

Reauthorization of Title II: Issues and Options

Three possible paths can be taken during the reauthorization with respect to the programs in Title II: current programs can be extended and improved, augmented by new programs, or replaced by totally new programs. With respect to the first option, the State Grants, Partnership Grants, and Teacher Recruitment Grants were all enacted in 1998. Thus, as pointed out by both GAO and ED reports, it is too early to determine whether they have led to increased numbers of highly qualified teachers or improvements in student achievement. GAO did find some positive results of the grant programs; for example, 85 percent of grantees are reforming teacher qualification requirements, 85 percent are providing professional development activities, and 72 percent are supporting teacher recruitment. Education professionals cite expanded professional development and improved recruitment as among the most important reform activities. Also, most grantees indicated that they are undertaking activities that they could not have otherwise pursued and are forming valuable partnerships in their states.

Since these programs provide one-time grants of three or five years, the intent of the programs would seem to be to jump start reform of teacher training and to demonstrate successful reform strategies. Because of limited funding, less than 10 percent of the 1,300 schools of education are participating in one or more of the programs. These programs have clearly not yet been able to directly leverage broad and significant change in teacher preparation. One option would be to continue the programs, in the hope of reaching more states and more teacher training programs over time, perhaps at an accelerated rate if appropriations increase significantly. Another option would be to expand the use of funds specified for both State Grants and Partnership Grants to reflect new priorities. In particular, these grants could be used to help programs meet the mandate of the No Child Left Behind Act, which stipulates that there must be a highly qualified teacher in every classroom by the 2005–06 academic year. Grants could also be used to help align the curriculum assessments and exit standards in K–12 education with postsecondary admission requirements.

Another alternative, based on an assumption of continued limited funding for these programs, would be to more explicitly focus them as demonstration programs. For example, the evaluation and accountability provisions could be modified to ensure that grantees systematically collect data about program characteristics and outcomes and use appropriate and consistent definitions and measures.

The Accountability for Programs that Prepare Teachers provisions of Title II, also enacted in 1998, were met with much controversy and criticism from the higher education community.

Some felt that the provisions were an inappropriate federal intrusion into state, local, and institutional control of education and that they also imposed a substantial reporting burden. The issue of regulatory burden is discussed in Chapter 9. Many in higher education also questioned the quality and utility of the output from these provisions. The first national report card indicated that, based on reports from the states, all or nearly all current teachers are fully certified. Many institutions and some states reported 100 percent pass rates on teacher licensure exams. Nationally, only one institution was labeled low-performing, and thirteen institutions were labeled at-risk for being low-performing.

Evaluations of the national report card by the Education Trust and the GAO concluded that the data were largely uninformative, in large part because of the way states interpreted the ED definitions. In order to accommodate variations in state policies and teacher education programs, states were permitted to interpret several terms in different ways, and as a result, the data produced were not consistent and comparable. For example, many institutions require that students pass state licensure tests before being allowed into teacher preparation programs. Therefore, these states could report a 100 percent pass rate on licensure tests for those students who completed their teacher training programs. This does not provide useful information about the potential teachers who were eliminated at the entry point or about those who completed the teacher preparation program. States also had discretion in interpreting the terms "alternate teacher certification" and "initial teacher certificate," which apparently resulted in an underreporting of the number of teachers certified through an alternate route and the number teaching under a waiver of certification requirements. Clearly, if these provisions are retained, an option for improving them would be to standardize the definitions in a way that would elicit more accurate and useful information about the status of teacher preparation at the state level.

Many in the education community also have voiced reservations about the appropriateness of using pass rates to evaluate the quality of teacher education programs in Title II. Of particular concern is that pass rates vary greatly from state to state. States use different teacher licensure tests, and, even among states that use the same tests, passing scores are often set at different levels. Some states do not use any test. Thus, while the state-level data can be informative in themselves, the state comparisons that are made in the national report card are unscientific and wholly inappropriate.

Furthermore, there is reason to suspect that reliance on a single pass rate measure of quality will disproportionately affect certain institutions, such as those that serve minority students, many of whom are from educationally disadvantaged backgrounds. If these institutions begin to pretest students who are interested in teacher education because of a concern about pass rates and the ranking of their institution and other consequences, then many potential teacher candidates, including many minority teacher candidates, may be lost. The law currently permits states to submit to the Secretary of Education a variety of evaluative data in addition to pass rates. These data could be assessed and reported to provide a broader and more nuanced picture of the performance of teacher training programs. However, thus far, the Secretary has failed to use any of the additional information provided to him in his public reporting. The Title II accountability program

could be strengthened by explicitly requiring that the Secretary's reports reflect all the information the states have submitted to him.

Options for adding new programs to Title II are nearly limitless. Through its history, the HEA has been host to dozens of programs to increase the supply of teachers and to improve the quality of the teaching force. The HEA as enacted in 1965 included two programs to improve the quality of teaching in K–12 education, Teacher Corps and a teacher fellowship program. Teacher Corps, one of President Johnson's original recommendations for the HEA, sent skilled teachers to impoverished schools. In 1967, the HEA was amended by the Education Professions Development Act, which added four programs to improve teacher training and recruit more teachers. This process of addition, as well as subtraction, continued through subsequent HEA reauthorizations. The 1992 reauthorization produced a HEA title for Educator Recruitment, Retention, and Development that included more than twenty programs, most of which were never funded. The 1998 HEA reauthorization repealed these programs and replaced them with the constellation of programs described earlier in this chapter.

Canvassing the previous programs in the HEA would produce options and models to deal with almost any conceivable issue relating to the size and quality of the teaching force. However, one continuing problem is the constant succession of new programs in each HEA reauthorization, almost none of which are given adequate time or resources to demonstrate their value. Continually uprooting the current programs and replacing them with yet another configuration of initiatives aimed largely at dealing with the same issues are unlikely to produce a more satisfactory result.

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3 "I can't afford to go to college."

Financial barriers to higher education access and persistence – grants

Background

Some students who are highly motivated and well informed about their higher education options and academically well prepared for higher education cannot afford to pay for it. These students face financial barriers to access and persistence in higher education. For example, as reported in Chapter 1, in 2000 there was almost a 30 percentage point difference between low- and high-income high school completers who were enrolled in college the October after they had graduated from high school. This chapter focuses on the role of federal need-based grant assistance in overcoming these financial barriers.

Student enrollment and persistence in higher education create public benefits – not only economic growth and productivity but also a more just and fair society. Expanding enrollments by including individuals who would not otherwise attend an institution of higher education increases the stock of these public benefits and should appropriately be paid for by the public through grant programs for financially needy students. Higher education also generates private benefits for those who attend – specifically, higher earnings and higher social status – that justify students' payment of some of the costs of their education. Nonetheless, the public benefits produced argue for government support to pay for at least part of the cost of higher education for those students who would not otherwise enroll.

Grants are a more effective means of encouraging students to enroll and persist in postsecondary education than other types of aid, such as loans and work. Grant aid directly reduces students' uncertainty and financial risk. Many low-income students do not have experience with borrowing or do not have confidence that they will be able to repay a loan. They may be reluctant to take out loans because of uncertain expectations of their future earning capacity. In addition, grants allow students to focus on their studies; their energy does not need to be diverted by an employer's demands. This increases the likelihood that they will complete their higher education program.

Grant aid is particularly beneficial for low-income students, who react more strongly to changes in tuition charges and aid than do middle- and upper-income students. Student enrollment behavior also is more sensitive to grants than to loans or work-study aid. Evidence from a series of research studies has consistently concluded that financial aid, and especially grants, has had a positive influence on the postsecondary participation of low-income students, even after taking academic background and other factors into

account. Low-income students who receive grants are more likely to go to college than are low-income students who receive other forms of aid or no aid at all.

Grant aid also encourages persistence in a way that loans and other forms of financial aid do not. Unlike a loan, a grant does not need to be repaid; it represents a direct decrease in the cost to the student, all else being equal. Unlike tax credits, grant aid tends to be targeted toward lower-income students, who may not have enough tax liability to take advantage of tax incentives. Research confirms that grant aid helps low-income and minority students persist. Federal grants also appear to allow low-income students to attend college full-time immediately after graduation from high school, rather than to delay enrollment or attend on a part-time basis, thereby eliminating to a degree risk factors for failure to persist. In a sense, then, most types of financial aid may enable access – i.e., the ability of students to initially enroll in some form of postsecondary education – but grants are particularly well suited to promoting other goals of financial aid, particularly persistence, for low-income students.

Federal grant aid is a fundamental aspect of the higher education financing system – a partnership among the federal government, state governments, institutions, and students and their families. The federal Pell Grant is often envisioned as the foundation of student aid – upon which other forms of aid are added – but the grant itself rests on a financing partnership. With state governments, this partnership is reflected in state appropriations to public institutions and state and local funding of low-cost community colleges. In fact, when the Pell Grant program was established, the initial award maximum was set, in part, to reflect the amount that a needy student would require to attend a community college. At private not-for-profit institutions, which generally do not receive state subsidies, Pell Grants have evolved into a foundation for institutionally funded grant aid.

The federal government has been deeply involved in the provision of grant aid since 1965. In that year, the Educational Opportunity Grant program (EOG, later renamed the Supplemental Educational Opportunity Grant, or SEOG) – the first federal grant program to students – was established as a campus-based aid program. In 1972, the HEA was modified to add the Basic Educational Opportunity Grant program (BEOG, later renamed the Pell Grant program), which aimed to provide a minimum level of resources to ensure access to postsecondary education. Because students would apply directly to the federal government for Pell Grants, the program also signified a policy decision that the federal government would help the neediest students attend a college of their choice through the provision of portable grants (vouchers) to students, rather than through the provision of student loans or direct aid to institutions (capitation grants). The campus-based grant program (EOG/SEOG) continued to exist to provide supplemental aid to students. The 1972 amendments also established the State Student Incentive Grant program (later renamed the Leveraging Educational Assistance Partnership, or LEAP) to encourage states to build on federal need-based grant efforts by creating or expanding their own need-based student aid programs.

Since the 1970s, however, borrowing and loan volumes have grown much more rapidly than have increases in grant aid, leading to what is often called the "grant-loan

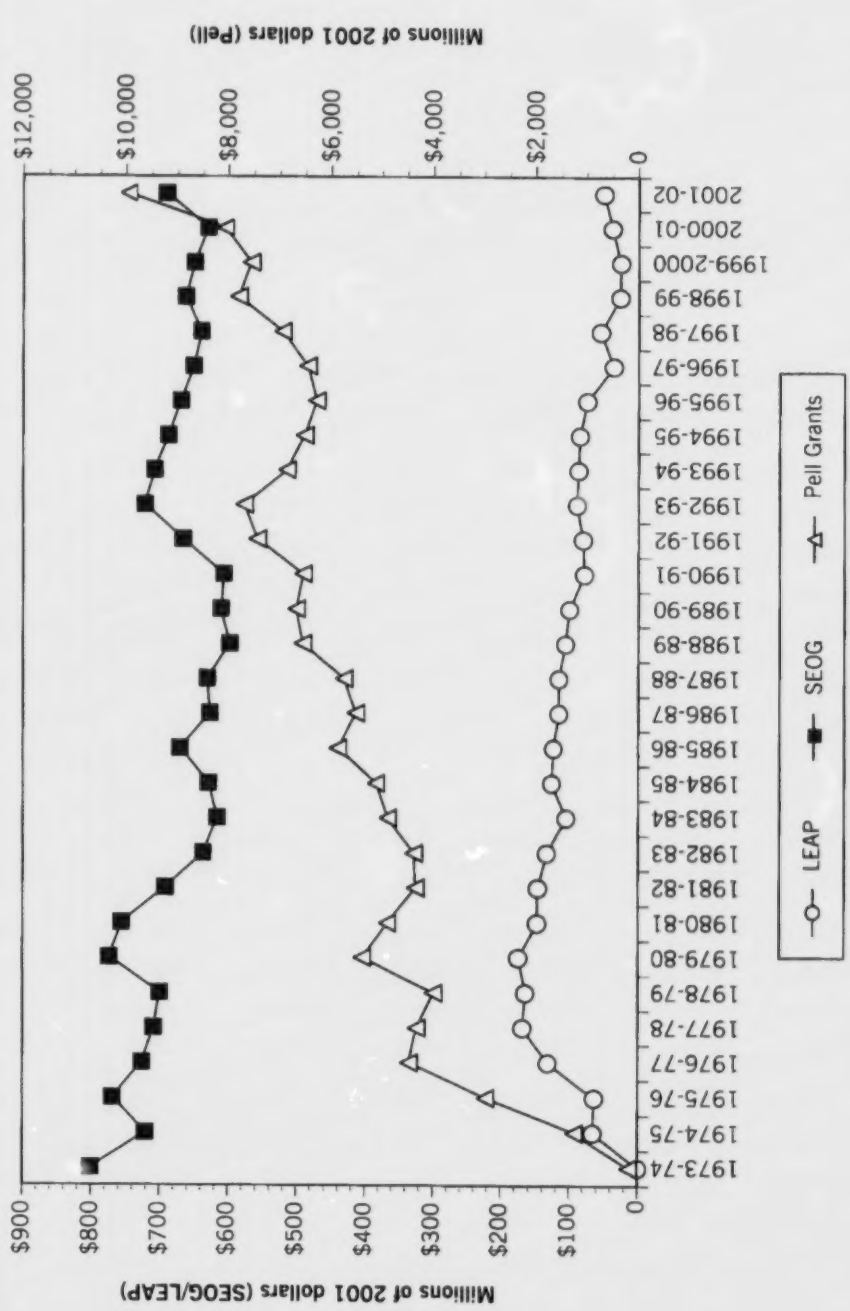
imbalance." In addition, many of the most recent initiatives in federal aid policy, including the HOPE and Lifelong Learning tax credits, do not significantly benefit low-income students. Also, the rapidly growing unsubsidized Stafford loans do not target low-income students (as they are not need based), although many students who receive need-based Pell Grants and subsidized loans also take out unsubsidized loans to meet a portion of their remaining financial need. The effect of these shifts has been to focus federal aid increasingly on middle- and upper-income families rather than on families with the greatest financial need. In large part, these shifts have occurred as a result of an environment that limits federal domestic discretionary spending and the entitlement nature of the loan programs (as opposed to grant programs). They may also reflect an implicit change in philosophy, from the belief that the benefits of higher education are broad and public, and therefore should be supported by spending taxpayer funds on grant assistance, to the belief that the benefits are largely private, thereby justifying having a larger proportion of educational costs borne by individuals through self-help (i.e., loans or work).

Ultimately, a combination of trends over the last decade or more has eroded the standing of federal need-based grants within the higher education financing system in general and the federal student aid system in particular. Since the 1970s, the federal financial aid system has been transformed from one that attempted to focus on need-based grants to one dominated by student loans today. By 2000–01, grants made up less than one-fifth of federal student aid awarded under Title IV.

Recent increases in appropriations for Pell Grants have helped significantly raise the Pell Grant maximum and stabilize the ratio between federal grants and loans. Nevertheless, after accounting for inflation, the maximum Pell Grant amount remains substantially lower than it was in the late 1970s, and it continues to be more than a thousand dollars below the currently authorized maximum. Funding for the federal SEOG program, after increasing in the mid-1990s, has been stagnant in recent years, and the amount of aid per recipient has declined. Federal matching funds through LEAP have been cut sharply in recent years, although the combination of state-funded grants and LEAP have increased on a per-recipient basis (see Figures 1 and 2).

Federal grant awards also have not kept pace with increases in tuition, leading to decreases in the purchasing power of federal grants. For example, the maximum Pell Grant award now covers 68 percent of the average price of attending a public two-year institution, 34 percent of those costs at a four-year public college, and only 13 percent at a private four-year institution. By contrast, in 1976–77, the maximum Pell Grant covered 94 percent of the average price of attending a public two-year college, 72 percent of those costs at a four-year public college, and 35 percent at a private four-year college. In order for the maximum Pell award to cover the same share of costs at public four-year institutions as it did in 1977, it would have to rise from $3,750 for 2001–02 to around $7,000. This erosion in the Pell Grants' purchasing power presents a particular problem for low-income students and their families, for whom the share of family income required to pay tuition has increased the most over the same time period (see Figure 3).

Figure 1: Available Federal Grant Aid, 1973–74 to 2001–2002



Source: College Board 2002.

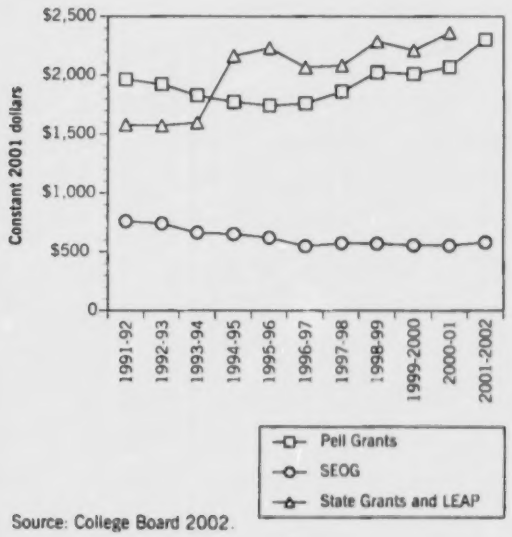
Grant Aid in the Higher Education Act

In 1999–2000, nearly one-quarter of all undergraduates received federal grant aid (Pell Grants or SEOG awards), and a substantial number of students received state grant aid encouraged by federal matching funds through LEAP. The provisions related to the major federal grant aid programs are authorized in Part A of Title IV of the HEA.

Pell Grants. The Pell Grant program provides direct grants to qualified undergraduate students (i.e., those enrolled in a degree or certificate program at an eligible institution and who have a high school degree or its equivalent) who demonstrate exceptional financial need. For many of these students, Pell Grants provide a foundation on which other types of financial aid are added. The law [Section 401(b)(1)] states that the purpose of Pell Grants is to "provide a Federal Pell Grant that in combination with reasonable family and student contribution and supplemented by [other authorized.federal grant programs] ...will meet at least 75 percent of a student's cost of attendance... " In other words, one expectation for the program was that needy students would pay for their education with no more than 25 percent self-help (i.e., loans and work).

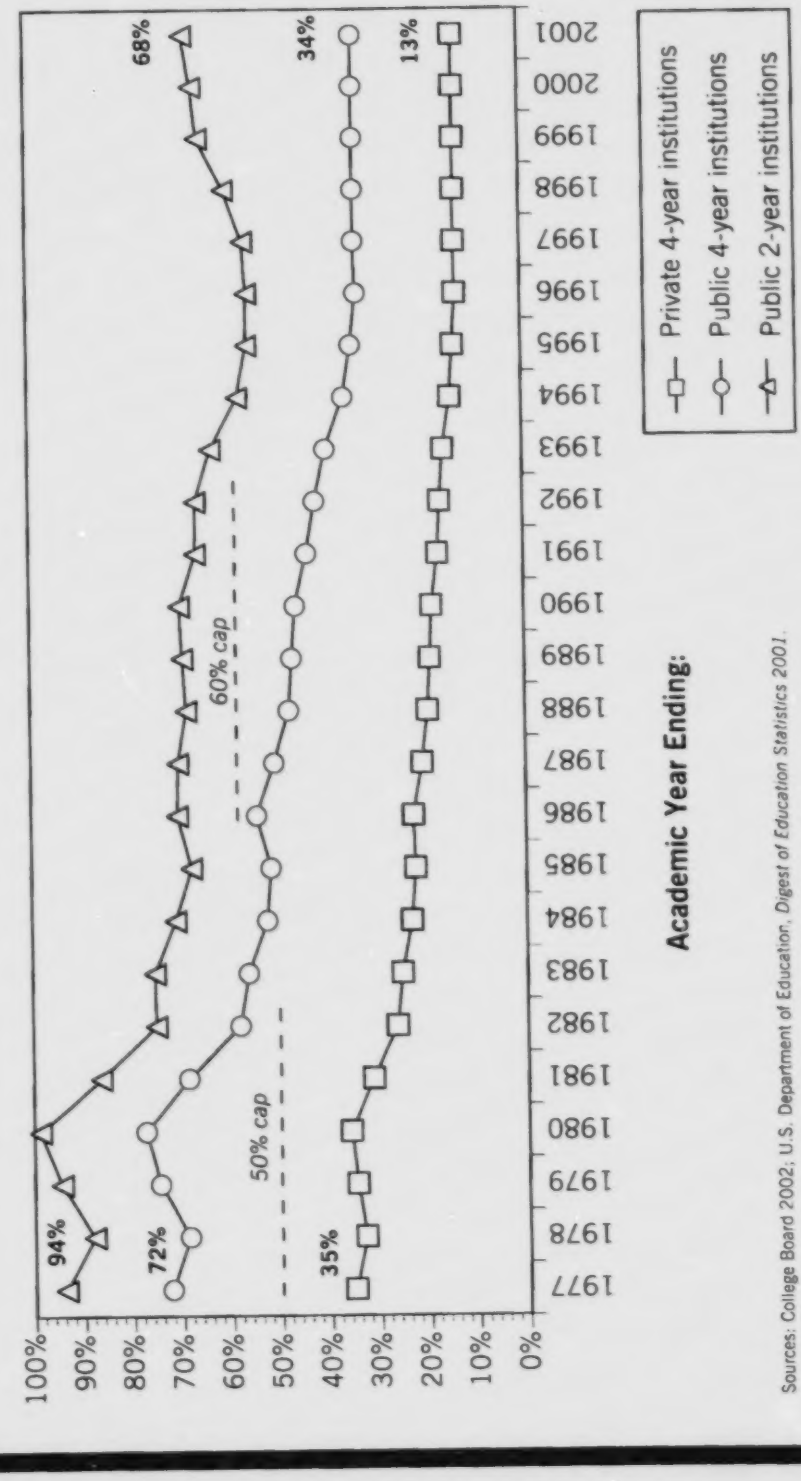
The amount of a Pell Grant award depends on several factors. In most instances, the amount awarded is the Pell maximum minus the student's expected family contribution (EFC). EFC is a measure of ability to pay that is calculated through the federal need analysis process, subject to a minimum (currently $400). In some cases, the combination of the Pell award and the student's EFC may exceed the student's total cost of attending a postsecondary education institution. When this happens, the amount awarded is the difference between the cost of attendance and the EFC, if that is the lower amount. For example, if the Pell maximum is $4,000 and a student has an EFC of $2,000 and cost of attendance of $10,000, then the maximum amount the student would be eligible to receive is $2,000 (the $4,000 maximum minus the $2,000 EFC). If the same student had a cost of attendance of $3,000, then the maximum amount the student would be eligible to receive is $1,000 (the $3,000 cost of attendance minus the $2,000 EFC). For most students, the Pell maximum is lower than the total cost of attendance so the relevant award rule is the Pell

Figure 2: Federal Grant Aid per Recipient, 1991–92 to 2001–2002



Source: College Board 2002.

Figure 3: Percentage of Price of Attendance Covered by Actual Maximum Pell Grants, by Type of Institution



Sources: College Board 2002; U.S. Department of Education, *Digest of Education Statistics 2001*.

maximum minus the EFC. The award is reduced if the student attends less than full-time. It is also subject to a tuition sensitivity provision (see below).

Pell Grant maximum amounts are authorized by the HEA for each fiscal year. However, the program is not an entitlement, and the actual annual maximum is set in the appropriations process based on available discretionary funds. As a result, the annual Pell Grant maximum is usually less than the authorized maximum. As of FY 2001–02, the appropriated maximum equaled the authorized maximum in only three years since the program's inception, the most recent occasion being in 1979–80. In all other years, the maximum Pell Grant has been less, often substantially less, than the authorized maximum. In 2001–02, for example, the authorized maximum amount was $5,100 (with a minimum of $400), the actual maximum grant was $3,750, and the average grant was $2,303 (see Figure 4).

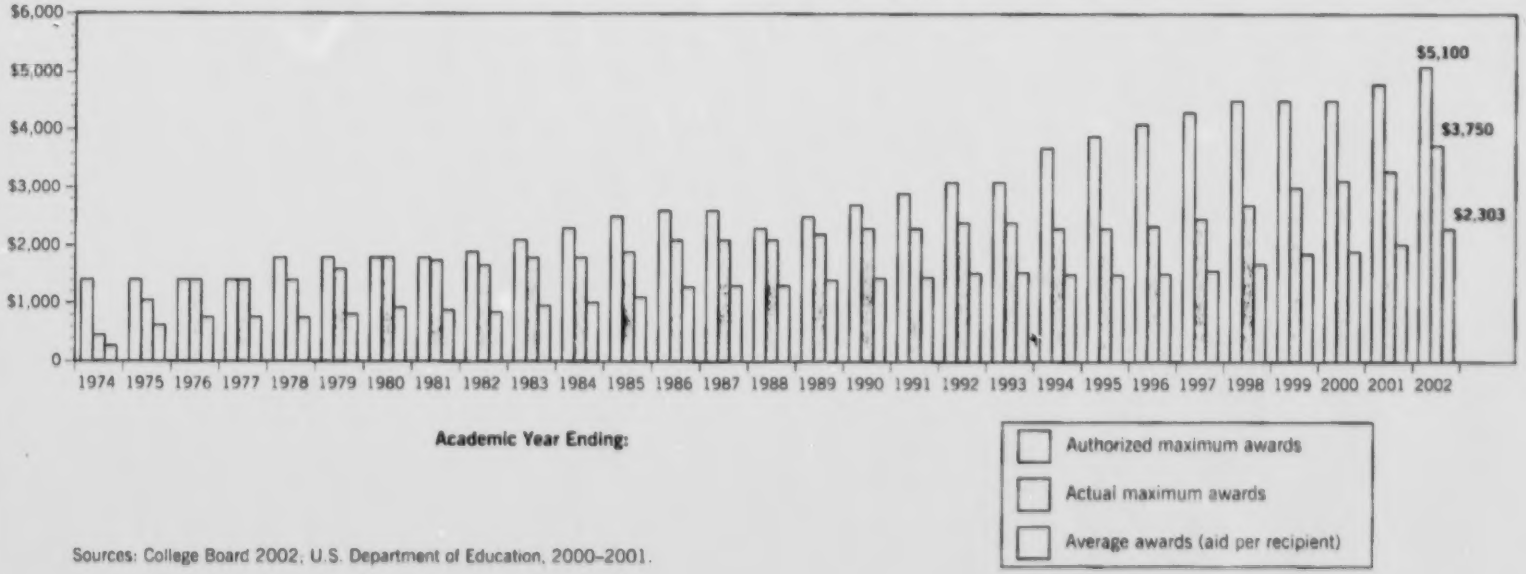
Pell Grants for the 2000–01 academic year totaled almost $8 billion. Consistent with the intent of the program, the rules for eligibility ensure that grants are targeted toward the lowest-income students. The overwhelming majority of recipients come from families with annual incomes below $30,000, and almost two-thirds of recipients reported family incomes of $20,000 or less. The average family income level of recipients is approximately $17,000.

In 2000–01, more than 5,000 institutions participated in the Pell Grant program, and almost 3.9 million students received grants. Thirty-seven percent of Pell recipients were enrolled at public two-year institutions and an additional 32 percent at public four-year institutions. Proprietary schools enrolled 14 percent of Pell recipients, private not-for-profit four-year institutions accounted for 15 percent of recipients, and the rest were enrolled at other types of institutions.

SEOG. The goal of the SEOG program is to help financially needy undergraduates meet educational costs by providing a grant supplemental to Pell that is administered through participating institutions. Institutions that participate in the SEOG program receive federal program allocations that they use to award grants to students on their campuses. Participating institutions must match federal program allocations with a contribution that must be equal to at least one-third of the federal contribution. Funds are allocated to eligible institutions on the basis of a formula that incorporates a guaranteed minimum (based on the institution's FY 1999 SEOG expenditures) and a measure of institutional need. Financial aid administrators use federal program rules to determine which students receive SEOG grants and the amounts students are eligible to receive. The law mandates that priority be given to students with "exceptional" need who also receive Pell Grants. After that, awards must be provided to undergraduates from families with the lowest EFCs.

In 1999–2000, the maximum SEOG award was $4,000 and the minimum was $100. The average size of a grant was $748, but average amounts varied by institutional type. Total federal allocations to institutions were slightly more than $600 million, for a total grant volume (including institutional contributions) available to students of about $875 million. Almost 4,000 institutions participated in the SEOG program, and about 1.2 million undergraduates received SEOG awards in 1999–2000. Public four-year institutions

Figure 4: Federal Pell Grant Awards



Sources: College Board 2002, U.S. Department of Education, 2000–2001.

enrolled the largest proportion of SEOG recipients (33 percent), followed by public two-year institutions (28 percent), private four-year institutions (24 percent), and proprietary schools (14 percent). Like the Pell Grant program, the SEOG program is strongly targeted toward lower-income students. SEOG awards are rarely given to part-time students, generally as a result of the choices made by institutions during the award process.

LEAP. The purpose of LEAP is to make incentive grants to states to encourage the continuation and expansion of existing state grant and work-study programs, and to establish community service programs to help financially needy students pay for postsecondary education. Participating states receive federal funds to help award grants or work-study funds to financially needy undergraduate or graduate/professional students. For each $1 of LEAP allocations it receives, a participating state must provide at least $1 of matching funds. If the total annual federal appropriation is $30 million or more, the match requirement increases to a $2-to-$1 match for the amounts in excess of $30 million. These "excess" amounts constitute a separate program, Special LEAP (SLEAP), in which funds can be used for expanding LEAP; for scholarships for degrees in teaching, mathematics, computer science, engineering, information technology, or fields critical to the state's workforce needs; for community service work-study activities; for academic scholarships for needy students; and for early intervention programs. The program has a "maintenance of effort" requirement that stipulates that the amount of a state's matching funds must be at least equal to the average amount it spent from its own resources for state scholarships for the prior three fiscal years.

Participating states make awards of up to $5,000 to students with financial need, based upon their own criteria (Alaska, Wyoming, Georgia and South Dakota did not participate in 2000–01). States may award aid to both undergraduate and graduate students. All participating states make awards to full-time students; some states make awards to part-time students as well. Unless prohibited by their state constitutions, state grant programs make awards to students at private as well as public institutions.

In 1999–2000 about 1.3 million students, primarily undergraduates, received state need-based grant awards that were funded by federal LEAP funds and state funds. The average award for undergraduates was $1,505, but the exact amounts varied by state. Federal LEAP appropriations for 2002–03 were $67 million, a slight increase after recent declines. In comparison, the total amount available to students for need-based state grants was more than $3.2 billion in 1999–2000, largely because several states – especially New York, California, and Pennsylvania – dramatically "overmatch" their LEAP allocations. Many other states, by contrast, provide only enough dollars to meet the maintenance of effort requirement and depend more heavily on LEAP to fund their need-based grant programs.

Issues and Options for Change

The current structure of federal grant programs has endured for three decades, suggesting that it has no major shortcomings that prevent the delivery of as much grant aid as is available to low-income students. However, some significant program design issues

are likely to be debated at the time of the HEA reauthorization. These include "front loading" the Pell Grant program, removing the tuition sensitivity provision in the Pell program, restoring the eligibility of certain groups of needy students, increasing efforts to ensure that funds are targeted toward the neediest students, and altering the campus-based aid allocation formula used in the SEOG program.

One of the main points of discussion regarding federal grant programs is the continued underfunding and declining purchasing power of these programs. The following options with respect to the grant programs merit consideration:

Pell Grant front loading. The idea of a front-loaded Pell Grant, which would reduce reliance on loans in students' early years of enrollment, has been raised since 1989. The original bill proposed to restrict borrowing under the Stafford program to those students who had completed two years of postsecondary education, restrict Pell eligibility to students in the first two years of study, increase the Pell award amounts, and make Pell Grants an entitlement program. During the 2000 presidential race, candidate George Bush raised the idea of an increased Pell amount for first-year students, a form of front loading. The arguments for and against front loading include:

- Part of the original vision for the Pell program was to extend free education for at least two years at the postsecondary level, for the neediest students.
- If funds are inadequate, the best use of limited monies is to award grants for the first two years of college in order to increase persistence rates, on the assumption that grant aid may have the most impact on persistence in the first year.
- Currently, the majority of student dropouts occur in the first two years of study, and students who drop out have a higher risk of default on loans than students who remain in school. Low-income and minority students have less experience as borrowers, may be more averse to borrowing, and are more likely to drop out and default. If front-loaded Pell Grants were to increase the persistence of these groups of students, the federal loan programs would save money.
- Front-loaded Pell Grants would limit the need for disadvantaged students to take out loans immediately after graduating from high school. After succeeding for two years in college, students might be more self-confident and willing to take on debt in subsequent years.

On the other hand:

- It is difficult to predict the actual impact of such a change, especially with respect to how many students would drop out in later years when faced with the prospect of reduced grants or the need to secure a loan.
- If students continue to drop out in early years, more grant dollars will go to students who do not complete their degrees. The changes might also create incentives for students to attend shorter programs.

- Front-loaded Pell Grants may create a heavier administrative burden. For example, it would be difficult to come up with a consistent definition of "first-year" and "second-year" students.
- Front loading could act as a kind of "negative reward"; in other words, the more successful a student is in progressing through postsecondary education, the more likely it will be that he or she will have to obtain loans. (The pay-off, in terms of increasing levels of education, might mitigate any such disincentive.)
- The potential benefits of front loading would be lost if institutional aid policies offset the federal change by offering less grant aid in the first two years.
- The new structure could prove to be more expensive, given the transition costs of getting a front-loaded Pell program up and running and the fact that more eligible students tend to be enrolled in the first and second years than in later years. Proponents of front loading often assume that appropriations would stay the same; however, in these scenarios, even the same level of appropriations would not ensure a "doubling" of the maximum awards. At the same time, there is a risk that appropriations would actually decrease due to the perception that students had received a huge increase in their award levels.
- Under most front-loading proposals, the amount of grant aid for needy students would not increase. The grant funds would simply be repackaged and targeted to needy first- and second-year students at the expense of needy third- and fourth-year students.

One approach would be to establish a demonstration pilot program to test the idea. The pilot program could be voluntary, limited to a small number of schools, and allow much flexibility with regard to program structure. It could include a sunset provision so that it expired with the HEA, thereby allowing any knowledge gained regarding the benefits or negative consequences of front loading to be applied during the next reauthorization.

Pell Grant tuition sensitivity. Another aspect of the Pell Grant program that could be changed is the tuition sensitivity provision, which reduces the award in some cases when the Pell Grant maximum exceeds $2,700. This provision provides that students eligible for the maximum Pell Grant receive $2,700 plus one-half of the amount by which the maximum exceeds $2,700, plus the lesser of 1) the remaining one-half, or 2) the sum of the student's tuition and dependent care expenses or disability-related expenses. For example, when the Pell maximum award amount is $3,300, the actual award is reduced if a student's tuition – plus an allowance for dependent care and disability-related expenses – is less than $300. The rule was enacted in 1992 as part of a larger compromise that eliminated a cap on Pell Grants that had existed through the first two decades of the program. This cap, the so-called half-cost provision, stipulated that Pell Grant awards could cover only 50 percent of a student's total price of attendance (a percentage that was later increased to 60 percent). Some have argued that this provision, in addition to being incomprehensible, has outlived its usefulness. It is primarily symbolic and affects few students. Moreover, it penalizes the neediest Pell recipients attending public institutions in low-tuition states. Only California community

colleges are affected at the present time, but increases in the Pell maximum award may affect students attending other low-priced schools.

Eligibility issues. In 1992, changes were made in the legislation to respond to the growing number of nontraditional students. For example, part-time students became eligible to receive prorated Pell Grants, and the limit on the number of years a student could receive a Pell Grant was removed. However, several groups of needy students are currently not served by federal grant programs. To provide eligibility to these groups, several changes could be made. In addition, changes could be made that target the grants more narrowly on the neediest students. These proposed eligibility changes raise the broader issue of the trade-off that occurs when grant funding is not increased. Should grant programs be targeted narrowly on the neediest lowest-income students in order to raise the maximum grant amounts and to maintain their purchasing power? Or should eligibility be extended to as many needy students as possible, even if the purchasing power of each grant diminishes?

One group of students who may be underserved by the grant programs is "very part-time" students – i.e., those attending college on a less-than-half-time basis. Many of these students come from educational or financially disadvantaged backgrounds. Some are single parents trying to get off welfare; others are working adults trying to upgrade their skills at a pace best suited to their needs. These students frequently take only one course, "stop out" in order to earn money to pay for the next course, and then return to school. In general, financial aid of all types is more limited for part-time students, and because less-than-half time students are less likely to persist and complete, the federal student aid system has tried to encourage at least half-time attendance. Very part-time students are extremely unlikely to receive Pell Grants, because the prorating of their award by attendance often reduces the award below the minimum.

For many of these students, even small grants would mean the difference between attendance and nonattendance and would encourage the completion of a degree or certificate. For other nontraditional students, however, forgone income and family responsibilities are barriers that are unlikely to be overcome with relatively small grants. Other potential problems are more technical. Expanding Pell eligibility for students attending college on a less-than-half-time basis or setting aside Pell Grant dollars for very part-time students would require a better accounting of such students' costs and resources. The distribution of relatively small amounts of financial assistance to these students also would cause administrative difficulty and increase opportunities for fraud and abuse. Finally, such a redistribution would spread existing funds even thinner.

Another group of excluded students is prisoners, who disproportionately are from low-income and minority backgrounds. The Violent Crime Control Act of 1994 made prison inmates ineligible for Pell Grants. Most state governments followed the federal lead and sharply reduced or ended their own support for prison education. Congress subsequently passed a Youthful Offenders Grant program to finance postsecondary education programs for inmates under twenty-six years of age and with fewer than five years to serve; however, this program gives states much less support for prison education

than the Pell program did. Meanwhile, numerous studies have shown that prisoner participation in postsecondary education programs provides skills that help them succeed when they are released, substantially reduces rates of recidivism, and is one of the greatest deterrents to future crime. Reducing recidivism rates would provide cost efficiencies, as the maximum annual Pell Grant is far lower than the average annual cost of operating a state prison bed (more than $20,000). As the number of adults in the corrections system continues to grow, it has become increasingly clear that prevention efforts need to be augmented. On the other hand, many feel that it is unfair to provide prisoners with a free college education at taxpayers' expense (although, taxpayers must pay for increased prison expenses as well).

The 1998 HEA amendments included a provision that banned student aid for those students convicted of possessing or selling illegal drugs. This includes any convictions as an adult in the years preceding a student's application for financial aid. Critics maintain that such a law denies aid to people who have given up drugs and are trying to turn their lives around. They also maintain that it has a disproportionate effect on poor and minority students. In addition, they raise several issues related to the essential fairness of the law: students who lie are not likely to get caught because there is no national database of state and local drug convictions; the law is applied unequally due to differing definitions across states regarding whether marijuana use is deemed a criminal offense; and the law constitutes double jeopardy because it fails to take into account any court-mandated penalty a student has already faced. Finally, students who are not reliant on federal aid are not subject to similar sanctions. For these reasons, many suggest repealing this provision or, at minimum, revising the legislation so that it applies only to those convictions that occur while a student is receiving financial aid. Another possibility is to make the denial of student aid an option for judicial sanctions. On the other hand, supporters of the law have argued that federal financial aid is a privilege, not a right, and that drug offenders do not "deserve" financial aid.

Another group of students who may be excluded from federal grant programs are those who attend colleges with high default rates. Current law mandates that schools that lose their eligibility to participate in the Stafford loan program because of high default rates also lose eligibility to participate in the Pell Grant program (see Chapter 4 for a discussion of the loan default issue). Many of these schools, especially community colleges, have relatively few borrowers; consequently, a few defaults can lead to a high default rate and loss of Pell Grant eligibility. These schools are often serving large numbers of needy students. It appears that some schools have stopped participating in the loan programs so their students will not lose eligibility for Pell Grants, thus reducing the financing options available to their students. Some argue that institutions and their students should not be penalized because they serve disadvantaged populations, who are more likely to default. On the other hand, many schools that lost eligibility because of high default rates also had inefficient, low-quality programs or fraud and abuse problems. The elimination of such schools from the Title IV programs has reduced the federal government's default costs and perhaps even improved the overall quality of postsecondary education.

Rather than expanding Pell Grant eligibility, funds could be focused more exclusively on the lowest-income students. Several options have been suggested including:

- Increase the Pell minimum award substantially, on the assumption that grants of only a few hundred dollars have little impact on the student's net price of attending most institutions and the likelihood that such students receiving very small grants would be less likely to enroll and persist in higher education.
- Eliminate the current rule that allows students who would otherwise be eligible for $200 to receive the $400 minimum award.
- Create a "bonus" Pell Grant that would be added to the maximum award for which students with negative EFCs qualify.

These options would narrow the focus of the program and redistribute funding to the neediest students. Implementing them would, however, mean that the awards of other groups of students would decrease or even be eliminated, unless the total funding for the program were increased at the same time.

SEOG allocation formula. The institutional allocation formula used in the campus-based SEOG program includes both a guaranteed minimum level, which is based on the institution's SEOG FY 1999 expenditures, and a measure of institutional need. However, since there have been no substantial increases in appropriations, about two-thirds of current appropriations are needed to cover the guaranteed hold-harmless level, leaving only one-third to be distributed solely on the basis of financial need. Critics have argued that this formula is outdated. They maintain that the current hold-harmless level is based on expenditure levels that prevailed in the mid-1980s and that it does not take into account major demographic shifts that have occurred over the past two decades. It underserves community colleges and low-priced four-year institutions, which enroll the largest numbers of disadvantaged students.

A frequent suggestion is to change the allocation formula for campus-based aid (which affects the SEOG program) by repealing the hold-harmless provision. Changing the formula by removing or reducing the guaranteed minimums would allow institutions that did not exist at the program's inception or have grown significantly since that time to gain a larger share of appropriations. Many of these institutions serve large numbers of disadvantaged students. However, such a change also would lead to dislocations. The current SEOG dollars are being awarded to exceptionally needy students, regardless of which institution they attend. A change in the formula would redistribute those dollars to different institutions and among different groups of financially needy students, but would not result in any net increase in the funds available to needy students.

Funding issues. Discussions regarding the reauthorization of federal grant programs are likely to focus on the fundamental need for more grant dollars. As the foundation of the financial aid system, the Pell Grant program is expected to cover a significant portion of price of attendance for needy students. This aspect of the issue is particularly important, given demographic projections that an increasing proportion of postsecondary students in

coming decades will come from disadvantaged backgrounds. Increasing amounts of grant aid will be necessary to encourage these students to enroll in postsecondary education and persist until graduation.

Despite increases in the authorized Pell maximums in recent years, attempts to obtain full funding for the authorized maximums have failed. Many advocates of federal grant aid believe that a new mechanism is necessary to achieve adequate levels of grant aid. As long as appropriations for federal grant programs fail to keep pace with inflation or with the rising costs of education, the programs will fail to serve the neediest students to the degree that they did in the past. In addition, the authorization of a fixed maximum amount for the Pell Grant program is designed to better inform disadvantaged students of the amount guaranteed to them. In fact, the goal of encouraging postsecondary aspirations was very much a part of the initial motivation for the Pell Grant program. The fact that appropriations have usually failed to match authorized maximums means that, in practice, students know the amount they can expect to receive only one year in advance. They do not know how much they can count on as they plan for higher education in middle and high school.

Perhaps the most straightforward solution to the need for more grant dollars is for Congress to appropriate enough money to fully fund the grant programs at the authorized levels. In the Pell program, increased funding would allow students to receive maximum awards at the authorized levels. Increased appropriations would also allow an expansion of the SEOG program, which would reduce the number of students who are currently eligible but do not receive grants due to shortages of funds, and an expansion of LEAP to encourage states to increase the volume of state need-based grants. Such increases in appropriations to fully fund the authorized award levels are not a reauthorization issue.

The trade-offs involved in increasing appropriations are clear. In general, grants are a better vehicle for influencing the behavior of needy students than are loans or tax credits. Thus, the availability of more federal grant dollars should encourage access, affordability, and persistence for the neediest students and decrease their levels of unmet need. In turn, these changes would be likely to increase the aid expenditures of institutions, as they enroll greater numbers of needy students. On the other hand, grants cost the government more than would a comparable volume of student loans.

Less clear is the possibility that increases in grant awards would provide an incentive for the lowest-priced institutions to raise their tuition to "capture" the extra dollars. (At higher-priced institutions, where prices are far above award levels, raising tuition would not result in increased grant awards available to the students they enroll.) The Pell Grant award rules focus federal grant funds on low-income students, and at most of these institutions, fewer than half of students receive such grants, making it unlikely that these grants are an incentive for institutions to raise their prices. However, increases in federal grant aid may displace institutional aid for low-income students rather than be added to the students' total grant amount, thereby enabling institutions to raise their prices and shift their institutional aid to other students.

Another option to increase grant dollars would be to make the Pell Grant program an entitlement, thereby removing it from the discretionary appropriations process. This change would halt the chronic underfunding of the program and eliminate the recurring problem of funding shortfalls. In addition, the change would take away some of the uncertainty faced by students and their families in planning to pay for college. Needy students would know how much Pell Grant money to expect – one of the original goals of the program. Supporters also argue that low-income students would borrow less, and therefore would default less often on student loans, thereby saving the government money it could use to offset the extra expenses associated with making Pell Grants an entitlement. However, this change in the Pell Grant program is likely to cost the government more money than it currently spends on this program, particularly if coupled with significant annual increases in the Pell Grant maximum.

In lieu of a full shift to an entitlement program, some have suggested the possibility of advance funding the program for four to five years, which should buffer the program from annual appropriations battles and give students more advance knowledge of the amount of grant aid they may expect to receive. Advance funding, however, would lock in future maximums, even in years in which the budget situation is improved and maximum funding might have been higher. Such a program would also require a very large initial appropriation as well as much better forecasting of Pell Grant funding needs several years into the future.

Another option is to form a new federal partnership with states and institutions to leverage more total dollars for need-based grant aid. Currently, both states and institutions complement federal student aid with their own need-based aid (in addition to direct appropriations from states to public institutions). Several possibilities for changing the roles of these partners have been suggested, including the following:

- A changed partnership with states might involve enhancing LEAP, which currently does not receive enough funding to substantially affect state behavior. More LEAP funds might encourage states that currently underinvest in state need-based aid programs (relative to other states) to invest more of their own funding. However, the current fiscal situation in most states will test state participation in the programs even as they currently stand.

- State matching funds could be leveraged to specifically supplement the Pell Grant program. For example, one could make any award above the current maximum subject to a state match. However, if the Pell program became a de facto state-by-state program, it might have the unintended consequence of undermining student choice and the interstate portability of the grants, particularly if states deny their portion of the aid to students who cross state lines.

- A supplemental grant program could be created that rewards the success of states or institutions in meeting the needs of lower-income students. For example, if an institution agreed to meet certain goals, e.g., to expand its proportion of low-income students, to implement programs aimed at reducing the drop-out rates of Pell recipients, or to improve its rate of graduating low-income students, grants could be awarded to the institution to be used for services such as counseling and tutoring or for grants to low-

income students meeting certain criteria. Similarly, incentives to states might include lowering prices at public institutions or increasing need-based aid programs.

- The current Pell Grant program structure could be replaced with a formula grant program that would award funds to the states, which would then make need-based grants to needy students. Federal funds might be given to states on the basis of population, total enrollment levels, the proportion of low-income students enrolled, or other factors. The new structure might function as an expanded LEAP, including federal/state matching grants and maintenance of effort requirements. However, the Pell Grant program historically has been much more successful than LEAP, which argues against such a radical restructuring. In addition, block grants to states have had mixed results. The object is to provide states with more flexibility in awarding students aid; however, the history of federal block grants suggests that they might lead to declining federal resources and an increased burden on the states to make up any funding shortfalls. Such a restructuring also might lead to unequal treatment of students, if students with similar needs are treated differently by different states (especially if grant portability across state lines was reduced).

In general, proponents of plans to use federal incentives to leverage more state or institutional aid dollars believe that this will lead to an increase in total grant funding, with benefits for needy students. Critics, on the other hand, raise several potential problems. Past attempts by the federal government to mandate the behavior of state governments have met strong resistance, and the ability of the federal government to manage state or institutional aid decisions remains minimal. It is also possible that states or colleges may raise their prices and then use institutional grant funds to discount the net price back to former levels, while qualifying more students for federal support. Even if federal incentives could be well structured, they might work differently in various state contexts, since states make different decisions about aid and tuition policies on the basis of their individual economic circumstances and goals. Further, creating a fully state-based grant system could lead to fifty different systems with competing rules and goals, adding more confusion to an already complicated financial aid picture and the potential for restrictions on student choices.

A final issue related to funding is the volatility in Pell program costs, which often leads to shortfalls in program funding. This happens when the appropriation is not large enough to pay for Pell Grants at the maximum grant specified in the appropriations legislation. Congressional appropriators use estimates from ED to determine where to set the maximum and the amount to appropriate that will fund the chosen award level for all eligible recipients. These estimates are not always accurate. For example, low-income students may enroll in greater numbers than expected, as is the case when the economy is poor. In fact, shortfalls in Pell Grant funding are relatively common, requiring supplemental appropriations. Currently, a $1.4 billion funding shortfall exists. The Bush administration's FY 2003 budget included a proposal that in the case of a Pell funding shortfall, the Secretary of Education would be able to reduce the award levels administratively through "reductive spending" power, i.e., the ability to reduce the maximum to below the level set in the appropriations bill, to the level that is financially viable. Current law mandates that the Secretary inform Congress whenever funding is

insufficient to fund Pell maximums fully, but does not give the Secretary the authority to unilaterally lower the maximum Pell Grant. Such a change might help the Department deal with funding shortfalls. However, this might have a negative impact on eligible students who had been expecting the higher award level. Others argue simply that Congress has the responsibility to fully fund the program to pay for the award level it set.

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4 "I can't afford to go to college."

Financial barriers to higher education access and persistence – loans

Background

Chapter 3 considered federal grant programs as means to aid students who would not otherwise enroll and remain in an institution of higher education. Loans are the second major strategy that students may use to overcome the financial barriers to access and completion of their education. The HEA loan programs are the Federal Family Educational Loan Program (FFELP), the Direct Loan Program, and the Federal Perkins Loan Program.

The student loan programs include taxpayer subsidies such as loan capital, loan guarantees, payments for defaults, subsidies to lenders, an in-school interest subsidy to needy students, and various servicing fees. These expenditures of public funds are justified because they produce public benefits in the same way as grant programs do. Public benefits include increased economic productivity and growth and a more fair and just society.

Students receive many more dollars to meet education costs per federal dollar spent in loan programs than in grant programs. It costs the federal government a little more than one dollar to provide a student with one dollar in grant assistance, including administrative expenses. On the other hand, students received about $11 in FFELP funds for each dollar of federal expenditures in the 2001–02 school year. While these additional dollars per federal dollar spent are made possible by the federal loan programs, it is the fact that these funds are borrowed, and must therefore be repaid with interest by the borrower, that creates this multiplier effect. These additional dollars and the cost of repaying them with interest are the student's investment in the development of his or her human capital. This investment yields the private benefits that the student will receive as a result of receiving postsecondary education – higher income, less unemployment, social status, and an enhanced quality of life. Thus, inherent in the student loan programs are public expenditures in return for public benefits and private expenditures (loan repayment) in return for private benefits.

Federal student loan programs have become a feature of American life. From 1958 through the 2001–02 school year, HEA loan programs made 161 million loans and disbursed a total of $476 billion. These programs have not developed according to an orderly and logical master plan. Rather, they have grown by accretion – much like a coral reef.

The Federal Family Educational Loan Program

The largest of the HEA student loan programs is the FFELP (originally named the Guaranteed Student Loan Program), which was enacted as part of the original HEA in

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1965. Politically, FFELP was intended to provide an alternative to tax-credit proposals under discussion at the time. It aimed to provide loans of convenience to finance the cash-flow needs of middle-income families. Loans are made to students by private lenders under terms (annual and cumulative loan limits and repayment conditions) specified by law. Student borrowers are not subject to any determination of creditworthiness. For students who demonstrate financial need, the federal government makes the interest payments on these loans while the students are in school. These are known as "subsidized loans." Students who do not demonstrate financial need are also eligible to borrow "unsubsidized loans." Parents can also borrow unsubsidized loans to pay for the educational expenses of their dependent children through the Parent Loans to Undergraduate Students program (PLUS). The loans are guaranteed against default in the first instance by guaranty agencies, and they are reinsured by the federal government, which is the de facto loan guarantor. These guaranty agencies provide default aversion assistance, pay default claims, attempt to collect defaulted loans, and provide other services to lenders and schools. The guarantors collect a variety of fees and retain a percentage of default collections to pay for their services and collection costs. The lenders are assured of a market rate of return on student loans by a legislative special allowance formula that provides for a federal payment to lenders when the interest rate paid by student borrowers falls below a market index. Student loans are frequently sold by the originating lenders to other eligible holders of student loans who act as a secondary market. In fact, FFELP loans can be bought, sold, and securitized like other commercial loan paper.

For the 2001–02 school year, the loan volume in FFELP was $24.7 billion, of which around 87 percent ($21.6 billion) was lent to 6.4 million students. The remainder ($3.1 billion) was lent to about 350,000 parents. FFELP loan volume was 68 percent of the borrowing under the HEA in 2001–02.

FFELP was designed on the model of several state student loan programs (e.g., New York, New Jersey, Massachusetts, Illinois, and Pennsylvania) that predated the federal program. The purpose of the original federal legislation was to encourage all states to establish student loan programs. The federal student loan program in this original vision would only serve as a "standby" to the state programs. Despite this initial concept, the federal student loan programs eventually became the dominant source of student loans in this country. The few remaining state-sponsored student loan programs are now less than 2 percent of the size of the federal programs.

The Direct Loan Program

The Direct Loan program is the second-largest HEA student loan program. It was initiated in the 1992 HEA reauthorization as a demonstration program. In 1993, the program was expanded to become a choice available to all schools. An institution of higher education can choose to participate in FFELP, Direct Loans, or both programs.

In the Direct Loan program, the federal government supplies the loan capital to the institutions of higher education. The institutions originate the loans to students and then

turn them over to the federal government, which is responsible for servicing and collection. The terms of the loans for the student are the same as those of FFELP, with the exceptions noted below.

One difference between FFELP and Direct Loans is that only the latter can offer borrowers an income-contingent repayment that bases repayment amounts on a yearly assessment of income, family size, and loan amount. Any loan balance remaining after twenty-five years is canceled. The uncertain cash flow of income-contingent repayments, the cancellation feature, and the inability of private-sector lenders to access Internal Revenue Service income data make this option unsuitable for commercial lenders in FFELP. In addition, only Direct Loans offer graduated and income sensitive repayment options with a term of more than ten years.

Another important difference between the two programs relates to certain features of consolidation loans. Both programs offer such loans, which enable student or parent borrowers to simplify their repayments by combining several types of student loans with different repayments into one loan. For the 2001–02 school year, $17 billion in consolidation loans were made to nearly 700,000 borrowers. Direct consolidation loans are available to borrowers who are still in school as well as those who have left school; FFELP consolidation loans, by contrast, are available only to those who have left school. Also, only Direct consolidation loans offer an income-contingent repayment option.

For the 2001–02 school year, the loan volume in the Direct Loan program was $10.6 billion, of which around 86 percent ($9.1 billion) was lent to 2.8 million students. The remainder ($1.5 billion) was lent to about 175,000 parents. Direct Loan volume was 29 percent of the borrowing under the HEA in 2001–02.

The idea behind direct loans in 1992 was to save entitlement funds through the less expensive direct loans and to use those funds for other purposes, such as expanding the Pell Grant program. Direct loans also promised a simpler administrative structure to the benefit of students, parents, institutions of higher education, and the federal government.

In 1993, the newly elected Clinton administration picked up the direct loan cause. In part, they were anxious to save entitlement funds for other purposes and to simplify program administration procedures. More important, they viewed direct loans as an important component of the administration's national service agenda. They wanted to counter the concern that students facing the prospect of high loan repayments would avoid relatively low-paying careers in public service occupations such as teaching, social work, public safety, or research and advocacy in nonprofit organizations. If all loan burdens could be made manageable through income-contingent repayment of student loans, they reasoned, an important barrier to national service could be removed. As noted above, only direct loans offer a mechanism for income-contingent repayment. Therefore, the Clinton administration proposed phasing out FFELP and replacing it with the Direct Loan Program. The ultimate political compromise was to have the programs coexist in "competition" with each other and to let schools choose the program in which their students would participate.

The Perkins Loan Program

The smallest and oldest of the HEA student loan programs is the Federal Perkins Loan program (Perkins Loans, originally named the National Defense Student Loans, NDSL), which was enacted by the National Defense Education Act in 1958. In the Perkins Loan program, the federal government supplies loan capital to institutions of higher education. The institutions originate loans to students and are responsible for loan collections. While the institutions are responsible for collecting Perkins Loans, most of them hire specialized student loan services to undertake this job. Indeed, a large industry of loan servicers has developed to undertake the actual administration of all the HEA student loan programs. Perkins Loan collections are deposited in a revolving fund at the institution, along with periodic infusions of new federal capital contributions and the institutional match and used to make additional loans.

There are important similarities between the Direct Loan and Perkins Loan programs. In both, the federal government is the source of capital and the school is the loan originator. There are, however, substantial differences as well. Perkins is a campus-based student aid program, as are SEOGs and the Federal College Work-Study program. This means that the campus financial aid administrator exercises considerable discretion in deciding which students will receive Perkins Loans. On the other hand, these administrators have much less discretion in deciding who can borrow a Direct Loan or a FFEL. This exercise of aid administrator discretion is particularly important, because there are not enough funds in the Perkins Loan revolving funds to meet the demand. Federal capital contributions are distributed by a formula to institutions of higher education. The campus-based distribution formula, as described in Chapter 3, allots participating institutions widely varying amounts of funds relative to the student demand for them. It is also important to note that only about 2,300 (36 percent) of the 6,400 Title IV-eligible schools participate in the program. Obviously, only students at participating schools can benefit from Perkins Loans. Another feature of all of the campus-based programs is that an institutional match is required. In the Perkins Loan program, institutions must provide a match equal to at least one-third of the federal capital contribution.

Perkins Loans are awarded only to students who demonstrate financial need. On the other hand, some Direct Loans and FFELP loans are need based (subsidized) and some are not (unsubsidized, PLUS, and consolidation loans). Perkins Loans are made only to students, whereas Direct Loans and FFELP loans are available to both students and parents. Finally, as noted above, schools have the responsibility for servicing Perkins Loans but not Direct Loans.

For the 2001–02 school year, the loan volume in the Perkins Loan program was $1.2 billion lent to about 700,000 students. The Perkins Loan volume was 3 percent of the borrowing under the HEA in 2001–02.

The Perkins Loan program was aimed at increasing the supply of teachers, scientists, and other higher-trained persons to win the newly declared "space race," which was created in response to the launching of the Soviet *Sputnik*. In the early days of the program, students intending to teach in elementary or secondary schools or who demonstrated superior

aptitude in science, mathematics, engineering, or modern foreign languages received special consideration. These restrictions were dropped in the 1960s, at which time Perkins Loans became generally available to students in all fields of study.

Readers interested in the details about the terms of each of the loan programs (e.g., loan limits, repayment options, interest rates, and eligibility requirements) are referred to the Department of Education's publication, *The Student Guide: Financial Aid 2003 –2004.*

Summary of the HEA Student Loan Programs

The three HEA student loan programs had a volume in the 2001–02 school year of $36.6 billion (not including consolidation loans). They provided almost 11 million loans to about 10 million borrowers, including about 9.5 million students and around 500,000 parents.

What started as a standby program to provide modest loans of convenience for students from middle-income families has evolved into a set of programs that are by far the largest source of federal student financial assistance. Loan programs are now the centerpiece of federal financial aid. Loans of convenience have become loans of necessity for those who cannot afford to pay for higher education with personal or family resources. Of the generally available aid provided by HEA programs, 75 percent of it was loans in the 2001–02 school year, 23 percent was grants, and the remaining 2 percent was earned through the Federal College Work-Study program.

Issues, Options, and Trade-offs

Capital Availability

The fundamental purpose of the HEA student loan programs is to enable students to borrow money for their educational expenses that they would otherwise be unable to borrow. Without these programs, students – particularly low-income students – would be unable to borrow to finance their education because, in the case of the commercial lenders in FFELP, there would be no collateral behind the loan. That is, if the student did not repay, there would be nothing tangible to seize or repossess, nothing comparable to a car or a house in the case of car loans or home mortgages. There would be no way for the lender to recover the loan principal, the amount lent. Students from affluent circumstances might have parents who would co-sign the loan, thereby offering their income and assets as a guarantee that the loan would be repaid. Students from low-income families would have nothing to offer as collateral or to guarantee repayment. Making a loan to such a student would be a very high risk and would be made only with prohibitively high fees and interest rates. As a result, these students would in effect be unable to borrow. They would be unable to invest in their own human capital to the benefit of the public and themselves.

The federal guarantee is the critical feature of the FFELP that enables capital to be made available to students who would not otherwise be able to borrow. Indeed, the law requires

that FFELP loans be made to students "without security and without endorsement" other than the federal guarantee. (Sec. 427(a)(2)(A)) The federal guarantee replaces the collateral that students lack. It assures the lender that the loan principal will not be lost. It does not make the loan risk-free, but it does make it very low risk. In the Direct Loan program, the federal government is, in effect, absorbing the risk and self-insuring itself as the provider of capital.

Beyond the federal guarantee, which makes capital available, and the payments for defaults that go along with it, the other features of the HEA loan programs (interest rate, in-school interest subsidy, grace period, deferments, cancellations, and lender special allowance payments) are all simply techniques for further reducing student costs of borrowing, making those costs more affordable. In other words, all these features are additional subsidies to lower the student cost of borrowing.

There is substantial evidence that the HEA student loan programs are no longer achieving their central purpose. They are no longer putting enough money in the hands of students who would otherwise be unable to borrow to pay their educational expenses. Not enough capital is being guaranteed. As will be discussed in detail below, students cannot borrow enough through these programs because the loan limits are too low. More precisely, the annual loan limits are too low. The aggregate loan limits permit a student to borrow the annual maximum for five years of full-time undergraduate study and five years of full-time graduate study.

Figure 1, taken from ED's *The Student Guide: Financial Aid 2002–03*, describes the current annual and cumulative loan limits for HEA programs.

To simplify the discussion, let us focus on the annual loan limits for the FFEL and Direct Loan programs. Students can certainly borrow Perkins Loans in addition to either a FFELP or a Direct Loan. However, Perkins Loans make up only 3 percent of total borrowing and are not available at 64 percent of Title IV-eligible institutions. Moreover, most institutions that participate in the Perkins Loan program do not have adequate capital to meet the demand from their students. There is no similar lack of capital availability in FFELP and Direct Loan programs. All students can borrow the full amounts of these loans for which they are eligible.

There are three indicators that the annual loan limits in FFELP and Direct Loan programs are inadequate. First, annual loan limits, especially for first-year students, have not kept pace with increases in higher education prices. Second, the result is a large and increasing unmet need gap between college prices and student resources, especially for financially needy students. Third, students are increasingly turning to other, much more expensive sources of credit to pay for higher education expenses. The following paragraphs look at each of these indicators in detail.

First, the annual loan limits for first-year student borrowers cover only a diminishing portion of higher education prices. First-year borrowers are the largest single group of borrowers (25 percent of total borrowers). More important, the first year is the point at

Figure 1: Federal Student Loan Limits

Annual Loan Limits for Subsidized and Unsubsidized FFELP and Direct Loans

Dependent Undergraduate Student		*Independent Undergraduate Student*		*Graduate Student*
1st Year	$2,625	1st Year	$6,625	$18,500 each academic year (only $8,500 of this amount may be in subsidized loans)
		Only $2,625 of this amount may be in subsidized loans		
2nd Year	$3,500	2nd Year	$7,500	
		Only $3,500 of this amount may be in subsidized loans		
3rd & 4th Years	$5,500	3rd & 4th Years	$10,500	
		Only $5,500 of this amount may be in subsidized loans		

Aggregate Loan Limits for FFELP & Direct Loans

$23,000 as a dependent undergraduate student	$46,000 as an independent undergraduate student (only $23,000 of this amount may be in subsidized loans)	$138,500 as graduate or professional student (only $65,500 of this amount may be in subsidized loans) The graduate debt limit includes loans received for undergraduate study.

Annual Loan Limits for Perkins Loans

Undergraduate Student	*Graduate Student*
$4,000 each academic year	$6,000 each academic year

Aggregate Loan Limits for Perkins Loans

$20,000 as an undergraduate student	$40,000 as graduate or professional student The graduate debt limit includes loans received for undergraduate study.

which students first gain, or fail to gain, access to higher education. It is the crucial threshold and foothold. The annual loan limit for first-year independent students is $6,625. The annual loan limit for first-year dependent students is $2,625. Both annual limits were established in the Higher Education Amendments of 1986, sixteen years ago. The annual limit for first-year dependent students, $2,625, is also virtually unchanged from the $2,500 level at which it was set in the Education Amendments of 1972, thirty years ago. Average tuition and fees in public four-year, public two-year, and private four-year institutions increased by about 300 percent between 1986–87 and 2001–02; annual loan limits for first-year students increased by zero percent. Extending the comparison back to average tuition and fees in 1972–73 would indicate increases in excess of 900 percent. As indicated in Chapter 3, the growth of the HEA grant programs also has not kept pace with increases in higher education prices.

Second, the level of unmet need (i.e., the portion of college expenses not covered by family contribution and all sources of student aid, including loans) has grown steadily in recent years and reached unprecedented levels. On average, unmet need is $3,200 for low-income students at two-year public colleges, $3,800 at four-year public colleges, and $6,200 at four-year private colleges. These high levels of unmet need discourage many high school graduates from enrolling and persisting in higher education. For example, in the 2001–02 school year, 406,000 college-qualified high school graduates from low- and moderate-income families did not enroll in a four-year college, and 168,000 of them did not enroll in college at all. In short, increasing numbers of students who are qualified to attend college cannot afford to do so because there is not enough money available to them beyond what they and their parents can pay.

Third, there has been immense growth in student borrowing from sources outside of the HEA loan programs. Commercial lenders are offering private-label or alternative student loans on terms less favorable to the students than the HEA student loans. Compared with HEA loans, these alternative loans may require a creditworthy cosigner, the payment of high loan insurance fees, higher interest rates, no in-school interest subsidy for financially needy borrowers, no deferments (including no deferment while in school), no cancellations, no consolidation option, no grace period, and fewer repayment options. In 1995–96 (the first year for which data are available), students borrowed $1.1 billion from these alternative loan programs. In 2001–02, they borrowed about $5.6 billion, a growth of more than 500 percent in six years. Anecdotal reports suggest that reliance on alternative loans, once largely limited to students at the highest-priced private colleges or the most expensive professional degree programs such as medicine or law, is taking place at a much broader range of less expensive higher education institutions. For example, a survey of low-income students at four-year institutions in New England found that 35 percent of them had resorted to an alternative loan.

In addition, more than 80 percent of students have credit cards. About 20 percent of those with credit cards have charged tuition and fees on them, and 57 percent have used a credit card to pay for books and supplies. Since more than 40 percent of the students carry a monthly credit card balance, according to one survey, there are a substantial number of students who

are borrowing with a credit card to pay their higher education expenses. The terms of credit card borrowing are much less favorable to students than those of HEA loan programs. Anecdotal reports indicate that credit card use to pay educational expenses is growing rapidly.

The conclusion would seem to be that students do not have access to sufficient funds to pay college prices, which have increased much more rapidly than the amount of student financial aid. As a result, some college-qualified youth do not pursue a higher education or shift their choices to lower-priced higher education programs. Other students fill the gap by borrowing through alternative loans or credit cards at much less favorable terms than those of the HEA loan programs. The three indicators seem to point clearly to the fact that the current annual limits in the HEA loan programs do not provide adequate access to capital to pay higher education expenses.

The obvious solution would be to substantially increase loan limits, particularly for first-year students. The current higher loan limit for independent students compared to dependent students seems justified, since independent students do not have access to parental support or parental borrowing capacity. It probably would be a welcome simplification to have one annual maximum for dependent students and another one for independent students. With one annual undergraduate maximum each for dependent and independent students, students and schools would not have to be concerned about a student's exact degree of progress (i.e., first-, second-, third-, or fourth-year students) in determining how much a student could borrow. One could, for example, have a loan limit of $5,500 per year for each year of undergraduate study by a dependent student and a limit of $10,500 for each year of undergraduate study by an independent student. In other words, these students would be able to borrow in each year of undergraduate study the amount that they can now borrow only in their third and fourth years. An increase in the annual loan limit for graduate students might also be appropriate, but there is no obvious level. A significant increase in the annual loan limits would give students more money with which to pay college expenses, reduce their unmet need, and decrease their need to use expensive credit sources such as alternative loans or credit cards.

Increasing annual loan limits would raise several concerns about possible trade-offs. For example, students from low-income families might find increased ability to borrow a barrier rather than a key to access to higher education. These students may be unfamiliar with borrowing and averse to taking on debt (or more debt). If their only choice is to pay for higher education through borrowing, they may choose to forgo higher education. There is no strong evidence in support of this aversion to borrowing thesis. Moreover, given that consumer borrowing such as credit cards and auto loans has become increasingly familiar, even among low-income families, the hypothesis is somewhat implausible.

As noted in Chapter 3, student aid through grants is better than aid through loans in terms of fostering access and retention among students who would not otherwise attend college. If the supply of grants is inadequate, loans are a second choice. The concern and conundrum is whether increasing loan limits, the second best policy, will reduce the incentive and the pressure to provide sufficient grants, the best policy.

As Chapter 7 indicates, increases in the availability of student loans cannot be shown to "cause" increases in college prices. Many variables come into play in the complex process of setting college prices for both public and private institutions. Nevertheless, there is a concern that more generous loan limits would facilitate price increases or create an environment in which tuition growth was easier.

Increases in annual loan limits in the HEA loan programs would increase federal costs in FFELP. These cost increases would be in mandatory or entitlement spending. Entitlement spending is sometimes characterized as "uncontrollable," in the sense that money must be spent annually to meet the obligations created by law until the law is changed. Both Congress and the executive branch (especially the Office of Management and Budget) are very cautious in creating new entitlements or expanding existing ones. Longstanding congressional budget rules ("paygo") that made new entitlement spending particularly difficult recently expired. These rules, which may be renewed, required that each entitlement increase be offset with an entitlement decrease or with a revenue (tax) increase. In the Direct Loan program, higher annual loan limits would not create a cost problem. An increase in Direct Loan volume would earn more money for the federal government, rather than costing it money, as will be discussed in more detail below.

There is great disquiet about the current level of student debt burden. Increasing annual loan limits would result in higher levels of debt and only exacerbate the situation. It is to this issue that we now turn.

Debt Burden

In 1999–2000, 64 percent of graduating students were borrowers under one or more of the HEA student loan programs. Similarly, around two-thirds of full-time students borrow as undergraduates. It will come as no surprise that those who do not have much money (students from low-income families) were more likely to borrow than those who do have money (students from upper-income families). Also predictable is that students attending the highest-price programs (i.e., professional schools, proprietary schools, and private four-year colleges) are the most likely to borrow, and those attending the lowest-price programs (public two-year colleges) are the least likely to borrow.

The trends are clear: more students are borrowing, and they are borrowing larger amounts. The percentage of graduating students who had borrowed rose by more than 50 percent since 1992–93. In the same period, the average debt grew from $9,188 to $16,928, an increase of more than 80 percent.

Many concerns have been expressed about the growth and level of student loan debt. As noted above, the prospect of debt may deter some college-qualified youth from pursuing a higher education. The prospect of borrowing may lead some students to choose their program on the basis of cost rather than educational appropriateness.

In addition, incurring student loan debt may distort the educational and life choices of

students. They may choose their program or major on the basis of its potential to generate enough income to make student loan payments rather than on the basis of their interests and talents. Similarly, they may choose a job for its loan-paying income potential rather than its congruence with their interests. In particular, they may avoid relatively low-paying jobs in teaching, social work, or other public-service-oriented occupations. They may forgo graduate or professional school because of the prospect of additional debt. They may defer marriage, parenthood, or major purchases on credit, such as a car or a house. Alumni debtors may be reluctant to be alumni donors.

Each of these educational or life decisions – what to major in, what job to take, whether to go to graduate school – is the result of a complex set of factors. The role, if any, of student loan debt in these decisions is not well understood. There is no clear evidence that student borrowing has the negative effects suggested above. An alternate hypothesis is that borrowing to pay for higher education expenses has simply become the norm – i.e., it is the way one goes to college. Therefore, the adequacy of funds available to students may be more important than whether these funds are in the form of grants or loans.

Another way to look at student debt is to view it in relation to the income of the student borrowers after they leave higher education. How "burdensome" is the student loan debt compared with income? Some students unquestionably borrow more than they can comfortably repay. Their loan repayments are a financial strain. The student loan industry suggests that student loan repayments should not exceed 8 percent of pretax income, although there is not a consensus that this is the appropriate standard by which to determine that a student's loan debt is burdensome. Analysts also disagree on how many student borrowers have loan repayments that exceed this level.

All borrowers can choose to repay their loans through income-contingent repayment. This option ensures that monthly payments are not "burdensome" or disproportionate to income. Income-contingent repayments may not exceed 20 percent of discretionary income, which amounts to 5 percent to 8 percent of total income. Borrowers can also switch as often as they choose among repayment options. Thus, they could choose to repay on an income-contingent basis during periods of low income and switch to another repayment option that reduced their outstanding debt much more quickly during periods of higher income.

The default rate should perhaps be the best measure of how burdensome loan repayments are. If loan repayment were becoming increasingly more difficult for a growing number of students, the default rate should be rising. Yet, the default rate for FFELP and Direct Loans has been steadily and dramatically declining for almost a decade. Thus, it would seem that student borrowers are doing a better and better job at managing their debts, which some analysts decry as increasingly "unmanageable."

The options for making the repayment of student loans less onerous include the following:

- Increase grant assistance, particularly Pell Grants, so that students will need to borrow less.
- Control the rate of increase in higher education prices.

- Decrease interest rates on student loans.
- Eliminate or reduce the origination and guarantee fees that are deducted from the student loan proceeds and that require the student to borrow more in order to pay college expenses. These fees are usually 4 percent of the loan amount.
- Increase borrowers' use of the income-contingent and other repayment options, as well as opportunities for deferment and forbearance of repayment.
- Make it easier for others, particularly employers, to repay student loans on behalf of the borrower.
- Make more generous the current deferments of repayment for periods during which the borrower is seeking and unable to find employment or is experiencing economic hardship because of the amount of loan repayments in relation to income. (The maximum length of deferment is now three years.)
- Although they will not be a direct part of the HEA reauthorization, the limited deduction of student loan interest from income for federal tax purposes, as well as other tax benefits related to student loan repayment, also reduce loan burden.

If a choice has to be made on where to invest additional federal funds in FFELP, it is probably more important that adequate capital to provide access is available on the front end rather than that repayment terms are favorable on the back end.

Defaults

If a student loan borrower does not repay, the federal government reimburses the loan holder for the unpaid loan principal in the case of FFELP or writes off the loan in the Direct Loan program. If the borrower dies or becomes permanently totally disabled, the federal government similarly reimburses or writes off the loan principal. These federal payments are the most important federal subsidy to the HEA student loan programs. These payments, and the federal guarantee that they reflect, absorb most of the risk in the programs. They make it possible for students without collateral to borrow to meet their higher education expenses.

Defaults are also an important consideration because their magnitude has become a measure of the success of the HEA loan programs. High default rates lead to substantial federal costs. More important, they undermine the public and political credibility of the programs.

High default rates, their costs, and their political consequences were central issues in reauthorization and reconciliation legislation dealing with the HEA loan programs in the 1980s and early 1990s. These concerns have largely dissipated because of the decline in the default rates.

Loan default rates can be measured in many ways, but the primary measure in the HEA is the cohort default rate, which is the percentage of borrowers who enter repayment in a

fiscal year and default by the end of the next fiscal year. ED began calculating this rate for FY 1987. For FFELP the cohort default rate peaked in FY 1990 at 22.4 percent. It declined for nine years, and the rate for FY 1999 for FFELP and Direct Loans was 5.6 percent, only one-fourth of the peak rate. For FY 2000 (the most recent year available) the rate ticked up to 5.9 percent. For the much smaller Perkins Loan program, the cohort default rate was 10.6 percent in FY 2000. The difference between the Perkins Loan default rate and that of the other programs is largely accounted for by the fact that Perkins Loans are made only to financially needy students, whereas loans in the other programs are made to both needy and non-needy students.

The dramatic improvement in the cohort default rate has at least four causes. First, the economic boom of the 1990s improved the employment and earnings of student borrowers and their ability to repay their loans. Research indicates that by far the most significant reason why students do not repay is lack of income; they simply do not have the money to repay. Low unemployment and economic prosperity are probably the best means to hold down the rate of defaults.

Second, the sanctions on defaulters (or, put positively, the incentives to repay) have increased significantly and are much more systematically and vigorously enforced. Student loan defaults are reported to credit bureaus, hurting the defaulter's ability to borrow from a commercial lender for any purpose such as a car or a house. The tax refunds of defaulters are seized to pay their loan obligations. Defaulters are subject to wage garnishment and lose their eligibility for future federal student aid. Perhaps most important, a culture of repayment has been created. Student borrowers know that they are expected to repay their loans and that severe negative consequences are certain to be visited on them if they fail to do so.

Third, the cohort default rate is used to determine the eligibility of institutions of higher education to participate in the HEA student aid programs. Institutions with cohort default rates of 25 percent or more for three consecutive years are excluded from the programs. Since the release of the FY 1989 rates in 1991, nearly 1,200 schools have lost eligibility. These schools were presumably not providing their students with the knowledge and skills needed to enable them to get a job paying enough to make it possible for them to repay their loans. By this logic, the elimination of these schools from HEA eligibility has made it more likely that students will enroll in other schools, where they will receive a better education and training that will enable them to repay and help lower the default rate.

Fourth, the enactment of the Direct Loan program in 1994 made income-contingent repayment available to all borrowers, including those who initially borrow through FFELP. Loan repayments under the income-contingent option are set annually at a reasonable level in relation to income. Thus, if inadequate income is the primary reason for default, income-contingent repayment by definition eliminates most of the cause for defaulting. The loss of eligibility for HEA student aid is a death sentence for many institutions, especially proprietary schools. High default rates also carry penalties for guaranty agencies and lenders. Therefore, it is reported that institutions, lenders, and guarantors are

encouraging students at high risk of default or on the verge of default to switch to the income-contingent repayment option. This may be one more reason for the decline in default rates. The increasing use of income-contingent repayment as a default-aversion mechanism would also suggest that the default rate is likely to remain relatively low and to be somewhat insulated from economic conditions.

Some institutions of higher education have vigorously protested the practice of tying their eligibility to participate in the HEA student aid programs to their cohort default rates. These institutions note that borrowers in repayment are no longer students at the institutions. They argue that the institutions have no control over these former students and should not be held responsible when they default on their loans. They point out further that most borrowers who default do so because they lack the money to repay their loans, and that the best predictor of whether a student will be low-income, and therefore unable to meet loan payments after he or she leaves school, is whether that student was low-income before being admitted. In sum, the net effect of using cohort default rates is to discourage institutions from admitting students from low-income families.

These arguments fell on deaf ears for more than a decade, because the use of cohort default rates, in fact, eliminated many low-quality schools from eligibility for the HEA student aid programs and appears to have been a significant factor in reducing default rates. Also, no alternative policy promising equivalent effects emerged. Complaints about the cohort default rate have become muted in recent years. Many who complained the loudest are no longer HEA program participants. Others have reduced their vulnerability by modifying their admissions policies or their educational programs or advising students at risk of defaulting to use an income-contingent repayment plan. In the most recent year, only five schools faced a loss of eligibility because of their high cohort default rates.

Approximately $202 billion is outstanding in FFELP and Direct Loan programs. Therefore, even a relatively low cohort default rate results in significant costs to the federal government. As loan volume has grown rapidly in recent years, default payments, which totaled about $2.4 billion in FY 2000, have also risen.

The default situation seems to be under control, particularly given that loans are made to highly mobile borrowers who are generally inexperienced with credit and who, at the time they borrowed, usually had no collateral or regular source of income. No major legislative initiatives to further reduce student loan defaults appear to be called for.

Cost

Critics sometimes maintain that student loan programs "cost too much." Since loan volume is the primary driver of program costs, this complaint can be interpreted as a call for fewer loans or less growth in loan volume. That is primarily an issue of the amount of capital that should be available, which was discussed above. Concern over excessive cost can also refer to default costs, which, as just noted, seem to be under control, apart from their growth as a by-product of increased volume.

The third variation on this theme is that FFELP lenders, holders, guarantors, and servicers are overpaid for the services they provide. FFELP participants counter argue from time to time that they are underpaid. These disputes arise because lenders and holders are supposed to receive a return on students' loans sufficient to cover their costs as well as provide them with a reasonable profit. Similarly, guarantors and servicers should receive adequate fees. However, the rate of return and the fees have been established by political negotiation since 1965, and they are therefore open to endless dispute and renegotiation.

In an attempt to break this cycle, Congress, in the Higher Education Amendments of 1998, established the Study of Market Mechanisms in Federal Student Loan Programs to try to get the ball out of Congress' court by letting the market set the appropriate return for lenders in FFELP. The study was conducted by ED and GAO and was intended to identify at least three market mechanisms. Most interest centered on options to auction off the right to originate student loans or to auction off student loans made by the federal government. The report, based on the work of a twenty-seven-person study group assembled by ED/GAO, was published in December 2001. It failed to recommend any specific market mechanisms and instead suggested "five general models for further evaluation." The study is a very valuable exploration of the complexities and difficulties of establishing a market mechanism. However, it did not provide Congress with a practical road map for replacing the system of politically negotiated rates of return. Congressional authorizing committees clearly do not have the expertise to devise a market mechanism on their own in the context of reauthorization. It is also clear that unless forced to do so, the executive branch will not devise or choose a market-mechanism alternative for the student loan programs. Therefore, if interest in moving in this market-mechanism direction remains, the next step could be finding a more effective means to mobilize the expertise of the executive branch to produce a concrete plan. For example, Congress could legislate a timetable for a transition to a market-based program, specify the performance criteria in terms of federal and student costs and repayment options, and ask the executive branch to devise a system by regulation to match the timetable and the performance criteria.

The 1998 Higher Education Amendments established another joint ED/GAO study to address a narrower cost issue in FFELP. Historically, the legislated return to lenders equaled the rate for the 91-day Treasury bill plus an additional amount. Lenders had long complained that the 91-day Treasury bill was no longer highly liquid and therefore not a good reference point for the cost of funds in the market. They sought a more accurate rate. Opponents of changing the rate argued that a new reference rate was unnecessary and just an inconspicuous way for lenders to increase their profits. The study was to explore the feasibility of using alternative financial instruments for determining lender yield in terms of liquidity and cost. The final report, issued in January 2001, again failed to come to a firm recommendation. However, more than a year earlier (in December 1999), Congress changed the reference rate to three-month commercial paper, reflecting a consensus proposal from the lenders. The result, at least in the short run, appears to be cost-neutral.

In recent years, another major cost issue arose concerning the yield to lenders from the student interest rate. When the Direct Loan program was adopted in 1993, significant

savings to the federal government were anticipated, particularly on the assumption that Direct Loans would entirely replace FFELP. Based on these prospective savings the interest rate to students and the yield to lenders beginning on July 1, 1998, became a variable amount equal to the "bond equivalent rate of the securities with a comparable maturity (to student loans) established by the Secretary" plus 1 percent. This would represent a substantial reduction in the student interest rate. It would also represent a substantial reduction in lender yield, but the assumption was that that would not matter, since commercial lenders would no longer be in the program by that date. In the event Direct Loans acquired only about a third of the student loan volume, the expected savings did not materialize, and commercial lenders were still making student loans. But, the reduction in the yield to lenders threatened to discourage, if not preclude, the willingness of commercial lenders to make additional student loans.

In the 1998 HEA reauthorization, the reduction in the student interest rate and the lender yield scheduled for July 1, 1998, was deferred to July 1, 2003. In the interim, the interest rate to students was decreased to approximately what it would have been had the change occurred as scheduled, and lenders were provided an increased special allowance. As July 1, 2003, drew closer lenders increasingly argued that there was a looming "crisis." They would be forced by the low rate of return to leave the program. A "fix" was enacted in February 2002, providing that the provisions enacted in 1998 be extended through July 1, 2006. At that time, the student interest rate will change from a variable rate to a fixed rate of 6.8 percent, and lenders will continue to receive a special allowance with no reduction in their yield. The fixed student interest rate was set on the basis of the expected average student interest rate over the next ten years if the 1993 rate provision had become effective on July 1, 2003. Providing this lower interest rate to students and continuing the yield to lenders at the 1998 rate will incur substantial costs to the federal government. The FY 2002 Budget Resolution anticipated the fix being enacted by providing for an increase of $8.2 billion in entitlement spending for the FFELP interest rate structure for the period 2001–11. This interest rate issue, which dominated the deliberations during the 1998 HEA reauthorization, appears to be off the table for this reauthorization.

The funding of guaranty agencies has been another focus for the examination of the cost of FFELP. The guaranty agencies are financed through a complex web of funding sources that are largely a legacy of the origins of FFELP in the 1960s and 1970s. Several of these agencies were the centerpiece of student loan programs in several states prior to the 1965 enactment of the HEA. The basic student loan strategy in 1965 and through the 1970s was to provide federal incentives and support for all states to establish guaranty agencies as the building blocks of FFELP. Changes in the last two decades, including the consolidation and standardization of lending and the mobility of students, have made FFELP a national program. The burden of proof would seem to be on those who would continue more than thirty independent guaranty agencies sustained by federal funding. The conversion of some or all of these agencies into providers of services to FFELP on a fee-for-service basis would seem to be the logical next step in the development of the program. One option would be to continue and expand the existing pilot program of this fee-for-service model as a transition for the future of the guaranty agencies.

All the cost issues mentioned thus far relate to FFELP. Direct Loans result in net financial gain to the federal government. Direct Loans make money for the federal government. This fact, although documented in the federal budget, has been hotly disputed using data that have been tortured to yield predetermined answers. Rather than wading into that statistical swamp, the case for Direct Loans making money is straightforward on a more general level. The return on student loans is the same for commercial lenders in FFELP and for the federal government in Direct Loans. This return to commercial lenders in FFELP must cover four costs: the cost of funds, servicing costs, defaults, and profits. In Direct Loans, the cost of funds, servicing costs and defaults are roughly the same as those for FFELP. Therefore, the federal government also makes a profit. This "profit" in Direct Loans is the net financial gain to the government, and it goes to the U.S. Treasury. Thus, if a major policy concern were to reduce the cost of the student loan program, an obvious option would be to revive the 1993 plan to fully transition from FFELP to Direct Loans. The federal revenue generated by an expanded Direct Loan program could also be used to offset the cost of increased loan limits or to provide other forms of aid to students.

Market Share

The student loan programs authorized by the HEA are big business. For example, in FY 2000 there was $147 billion outstanding in FFELP and $56 billion in Direct Loans. Assuming that these student loan assets yield 7 percent per year on average, these student loans produced about $14.2 billion in gross revenue to holders of student loans, including lenders and secondary markets. In other words, in FY 2000 the size of the HEA student loan business was $14.2 billion to hire people, buy technology, rent facilities, and distribute as profits. As with all businesses in a market economy, growth is an imperative. As loan volume has grown rapidly in the last decade, the HEA loan business has also grown, with the value of loans held growing for all as the pie got bigger. A second way for loan holders to grow is to increase their share of the market, i.e., to take a bigger slice of the pie.

Those who are losing in the quest for market share often decry the "destabilization of the program" that is occurring or impending, and they call for legislative remedies to "level the playing field," i.e., limit or reverse the success of their competitors. The latest arena in which the competition for market share is occurring is with respect to consolidation loans.

Under the consolidation loan program, a student with multiple variable-rate student loans can convert them into one fixed-rate loan. This program, which has grown rapidly since it was authorized in its current form by the Education Amendments of 1992, amounted to $17 billion in loan volume in FY 2002. This dramatic growth is in part a function of students having more loans as they borrow for more years of undergraduate and graduate study. Also, students are more mobile and now borrow while enrolled at institutions in different locations. As students finish school, they want to simplify their repayment by converting loans from multiple sources into a single loan with a single repayment, which was the primary intent of the program when it was created. Consolidation into Direct Loan income-contingent repayment has become an

increasingly common strategy for averting student defaults, and it also accounts for the growth in loan consolidations. Finally, in the extraordinary low-interest environment of recent years, students are using consolidation loans as a way to refinance their loans at a lower, fixed-interest rate and to lock in that lower rate for the life of their repayment. When a student consolidates his or her debt, loans are taken from the portfolios of one or several lenders and are placed in the portfolio of a lender that may not have held any of these loans initially. Therefore, some holders and lenders are seeing their loans portfolios erode. Other lenders are successfully competing for consolidation loans, and their portfolios are growing.

This situation of rapid growth in consolidation loans and winners and losers in the competition for consolidation loans has raised several issues. Are students being persuaded by aggressive advertising to consolidate their loans when it may not be in their interest? Would it destabilize the program to abandon the current requirement that students who have all their loans with one holder cannot easily consolidate those loans with another lender? Or does this "single-holder" rule create an unfair monopoly that thwarts student choice and access to the best loan terms? Are some lenders unfairly frustrating student efforts to consolidate their loans by erecting bureaucratic obstacles to losing loans from their portfolios to a new consolidation lender? When students consolidate their loans and receive a lower interest rate, the federal government must pay increased subsidies to maintain lender yield at a market rate. Are these increased lender subsidies for consolidation loans the best use for a growing portion of federal spending on student loans?

Consolidation loans do not result in any increase in the amount of financing available to students for their higher education expenses. After higher education has been completed, consolidation loans simply replace multiple outstanding loans with the same amount in a new outstanding loan. The basic policy objective of the student loan programs is to help students who could not otherwise pay for higher education to do so. From this policy point of view, it scarcely matters which lender makes consolidation loans after the student finishes higher education. Indeed, it can be argued that repealing the consolidation loan program would not seriously damage the central goal of student loans. It is nice that students can combine the repayments on several loans into a single repayment. A mechanism to avoid defaults is useful. It is also good that students can reduce their loan payments by using consolidation to refinance their student loans. However, it is fanciful to believe that students who would not otherwise enroll in higher education are persuaded to do so because of the availability of loan consolidation options years down the road.

The most significant risk with loan consolidation is that the reauthorization debates will be dominated by rival camps of lenders and holders squabbling over shares of the student loan market. Such a hijacking of the reauthorization is a distinct possibility given the high financial stakes, which encourage and enable those with an interest to deploy large lobbying armies. Loan consolidation and other issues relating to who gets what market share should be sideshows; they should not take center stage in the HEA reauthorization.

Perkins Loan Program

In the name of simplification for students, institutions of higher education, and the federal government, it has been suggested that the Perkins Loan program be abolished. Since the program provides only about 3 percent of the loan funds available through the HEA and serves students at only 36 percent of the Title IV-eligible schools, it would not seem to make a significant contribution to assisting financially needy students. On the other hand, while the relative contribution of Perkins Loans is small, it is significant in absolute terms. In the 2002–03 school year, more than 700,000 students are borrowing $1.2 billion at a time when available federal aid is far from meeting student need. If Perkins Loans were abolished, these 700,000 students could not recoup the lost access to low cost capital unless loan limits in FFELP and Direct Loans were raised to cover the full cost of attendance. Otherwise there will always be students with an additional need to borrow beyond FFELP and Direct Loan limits who could have satisfied at least some of that need with a Perkins Loan. In addition, Perkins Loans provide campus financial aid administrators with flexible loan funds that can be used in creating the most effective "package" of financial aid for needy students. This discretion has been used to provide Perkins Loans to very needy students – those from families with incomes lower than those borrowing subsidized and unsubsidized FFELP loans. Perkins Loans also leverage additional funds with the requirement of an institutional match equal to at least one-third of the federal capital contribution.

If it were decided to eliminate the Perkins Loan program, one way to phase it out would be to end new federal capital contributions and new loans and require that institutions of higher education participating in the program channel all collections of outstanding Perkins Loans into the SEOG program on their campus. This would ensure an orderly method for phasing out the program that would give institutions an incentive to continue collecting outstanding Perkins Loans that does not take Perkins Loan funds away from the institutions that have been faithful custodians of the program – in some cases for more than four decades – and that increased the funding for need-based grants.

Cancellations and Forgiveness

Canceling in whole or in part the student loans for those who choose legislatively favored occupations has been a feature of the HEA student loan programs since their beginning in 1958. What is now the Perkins Loan program provided for the partial cancellation of loans for those who became teachers in elementary and secondary education. The Perkins Loan program now contains eleven categories of occupations that, if pursued by the borrower, lead to loan cancellation. Most of these categories were added in the 1992 and 1998 HEA reauthorizations. These provisions generally provide a percentage cancellation for each year of service in the designated job up to complete cancellation or a lesser statutory maximum. Cancellation of Perkins Loans is relatively simple from an administrative standpoint, since the federal government only has to reimburse the institutions of higher education participating in the program for the loan amounts that they do not collect. These reimbursements to institutions for Perkins loan cancellation amounted to $67.5 million in FY 2002. Cancellation of Direct Loans would be even simpler; it would merely

involve a bookkeeping transaction under which the federal government would transfer funds among accounts. Cancellation in FFELP would be more complicated, since the ED Secretary would have to pay the loan holder on behalf of the individual student borrower. Since loans can move among holders as commercial paper and borrowers can switch holders (for example, through consolidation), providing timely and accurate payments would be very administratively challenging. Thus, it was only in the 1998 HEA reauthorization that FFEL and Direct Loan cancellation was first authorized for various types of K–12 teachers (Section 428J) and for child care providers (Section 428K). Both of these provisions must be funded by annual discretionary appropriations. Only the child care cancellation has received any funds ($1 million in FY 2001 and 2002), which is provided on a first-come, first-served, basis to eligible applicants. Loan cancellation remains very popular in Congress, with numerous bills having been introduced to expand existing cancellations or to add new ones, such as for social workers employed by child protective agencies. On October 1, 2002, the House passed legislation (H.R. 5091) to expand the (unfunded) teacher cancellation provided in Section 428J. The details of all of the existing cancellations are described in ED's *The Student Guide.*

These loan cancellations are not good public policy for three reasons. First, lenders, holders, institutions of higher education, and ED are encumbered with significant administrative and regulatory burdens in the HEA loan programs to provide benefits to relatively few borrowers.

Second, the cancellation benefits are too small in absolute dollars to influence the students' choice of occupations. It is very unlikely that students will, for example, choose to become teachers and remain in the teaching profession for a number of years because of a few thousand dollars per year in loan cancellation. Essentially, these cancellations reward students for doing what they would have done anyway, rather than getting more students to follow the legislatively desired path. They do not result in a net increase in the supply of people in the desired occupation. In fact, these cancellations can be viewed largely as thinly disguised federal salary supplements for various kinds of inadequately compensated state and local public employees, such as teachers, law enforcement officers, social workers or corrections officers. If this is the goal, it would seem better to do it openly and directly.

Finally, and most important, even if cancellations were large enough and certain enough to influence student career choices, they would still not be a good idea. This "Leninism-lite" – intervention in the labor market through loan cancellations to increase the supply of desired types of workers – would not work. What we know from the last eighty years of history is that central planning does not and cannot ensure that the right number of people with the right skills will show up in the labor force at the right time. The reason is that government cannot act quickly and flexibly enough to meet labor market demand. A better approach could be to provide students with more labor market information and with more generally available student financial aid. They will follow labor market signals, get appropriate training, and fill needed jobs much more quickly driving on their own rather than following signals from government.

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"How do student financial aid and tax policy fit together?"

Relating HEA programs to education tax breaks

Background

The federal system for awarding student financial aid relies on our nation's tax laws to provide key determinants of aid eligibility. Every six years or so, Congress reviews and revises these financial aid rules when it reauthorizes the HEA. Between each review of federal financial aid programs, Congress will almost certainly have made changes to the U.S. tax laws. Some of those changes are minor, while others significantly alter tax obligations and the distribution of the burden of taxation.

Thus, with each HEA reauthorization, policymakers face some fundamental choices. They may assess the impact of changes made to the tax code on financial aid programs and seek to make adjustments to respond to or offset in some fashion new tax laws, or they may ignore tax law changes and focus on other issues.

The upcoming HEA reauthorization, perhaps more than any process in recent memory, will present this issue in stark terms. Over the last six years, Congress has adopted a series of significant tax changes and added a number of provisions to tax laws that were designed to help American families pay educational expenses. Thus, the reauthorization will present policymakers with the opportunity not only to assess the overall changes made to our tax laws in recent years but also to examine the complex interactions between new, education-specific tax rules and federal financial aid policies.

Given the magnitude of the tax changes that have occurred since Congress last reauthorized higher education programs, such focus is understandable. The education tax incentives adopted by Congress have been estimated to reduce income tax collections by $8.5 billion during FY 2003. However, the mere presence of such tax rules does not determine their impact on the awarding of federal student financial aid.

For example, under the overall design of need analysis, approximately two-thirds of all Pell Grants are awarded without taking into consideration any asset information due to the income level and the type of tax return filed by the applicant. More than 93 percent of Pell Grant recipients report net assets of less than $7,500.[1] If Congress decides to maintain the basic structure of need analysis in the upcoming reauthorization process, then

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[1] These data are available because, due to the structure of the Free Application for Federal Student Assistance form (the FAFSA) applicants are asked to provide asset information, even if they are eligible for one of two formulas—the automatic "zero EFC" formula or the simplified formula, both of which exclude asset information in determining a student's eligibility for federal aid.

whether or not applicants for student financial aid are required to report the value of education savings plans, for example, is unlikely to have a significant effect on their eligibility for Pell Grants.

While some of the education tax programs are designed to encourage families to create assets to meet future educational expenses, each of these tax provisions has an impact on an applicant's adjusted gross income, actual tax liability, or both. This is significant because, when applying for federal financial aid, applicants use their adjusted gross income and federal income tax liability from their most recent tax return. Tax rules that affect these amounts invariably ripple through the aid formula itself.

Figure 1: Aid Available to Students During FY 2002

Pell Grant	$10.7
SEOG	$0.9
Federal Work Study	$1.2
Perkins Loans	$1.2
LEAP	$0.2
Military	$2.3
FFEL and Direct Loans	$37.9
Total	**$54.4**

Notes: All figures are in billions of dollars.
Sources: Military aid is AY '01–'02 estimate from College Board's, *Trends in Student Aid 2002*. All other figures are from FY 2003 U.S Department of Education Budget Summary.

Congress has a variety of policy options at its disposal to handle the interaction between these tax programs and the student aid programs. The debate will center around three issues – simplicity, fairness, and targeting. Complex reporting requirements can be developed to assemble a comprehensive economic profile of each applicant for federal student financial aid so that these education tax programs are factored into the process of determining eligibility for federal financial aid. A decision to exclude these education tax programs from the financial aid

Figure 2: Estimated FY 2003 Cost of Education Tax Provisions Enacted by Congress in 1997 and 2001

HOPE and Lifetime Learning Tax Credits	$4.3
Coverdell Education Savings Accounts	$0.4
Above-the-Line Tuition Deduction	$2.1
Tax-Free Employer-Provided Educational Benefits	$0.7
Student Loan Interest Deduction	$0.6
Section 529 Savings Plans	$0.2
Penalty-Free IRA Withdrawals	$0.2
Total	**$8.5**

Notes: All figures are in billions of dollars.
Source: All estimates prepared by the Congressional Joint Committee on Taxation.

system may weaken the targeting of federal aid. Finally, issues of fairness within the formula itself will inevitably be raised – if applicants are required to report workers' compensation and TANF benefits, for example, some may argue that these education tax benefits should not escape reporting.

This chapter presents an overview of the various education tax provisions that have an impact on the federal student aid formula and introduces the theory and operation of the various student aid formulas and how these tax provisions ripple through them. The chapter concludes with some options for Congress as it reviews these issues in preparation for the reauthorization of the HEA.

A casual glance at Form 1040 and its instructions will confirm what has rapidly become common knowledge – there are a wide variety of tax benefits related to higher education. Some of these benefits fill a unique role; others overlap. For ease of description and to help policymakers consider the interactions between these tax rules and financial aid programs, the tax benefits described in this section are organized into three sections: 1) tax incentives to save for college expenses; 2) tax rules that apply to payments for tuition and other fees; and 3) tax treatment of student loans.

Tax Rules for College Savings

The most visible college savings devices are collectively referred to as "529 plans," named after the Internal Revenue Code (the Code) section that prescribes their tax rules. These plans, now offered by all fifty states and the District of Columbia,[2] offer significant tax savings for families looking for specific college savings accounts. The 529 plans generally fall into one of two categories: 1) "prepaid" plans, which involve the purchase of a contract specifying the type of educational program (such as a two-year education at a community college or a four-year education at a public college or university) that the contract may be redeemed for and the payment schedule needed to fulfill the contract;[3] and 2) "savings" plans, which offer market-based returns based on the type of investment selected by the plan owner. Under federal rules, individuals can contribute after-tax funds to these accounts and the funds are allowed to grow on a tax-deferred basis. If the funds are withdrawn to pay certain higher education expenses, no federal income tax will be due.[4] Individuals of any income level can contribute to, and benefit from, 529 plans. The Code contains rules designed to discourage the "over funding" of 529 plans. Withdrawals not used for educational purposes are

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[2] Under the terms of the 2001 tax legislation, educational institutions, either themselves or in a consortium, may begin to offer prepaid tuition plans. Withdrawals from these plans will become tax-free in 2004. A consortium of almost 300 private institutions is preparing to introduce such a plan, which may become available in 2003.

[3] It is often thought that prepaid tuition plans allow families to purchase "tomorrow's tuition at today's prices." While the calculation of how plan sponsors ought to price prepaid tuition contracts generally relies on current tuition levels, it may be difficult for families to see a direct correlation between the two when they examine the payment schedule.

[4] Withdrawals made before January 1, 2011, will qualify for this tax-free treatment. The 2001 tax legislation that made this change expires on December 31, 2010. Unless Congress extends this rule, withdrawals in 2011 and beyond will be taxable income for the beneficiary (student), who generally faces a lower tax rate than the individual (such as a parent or grandparent) who funded the 529 plan.

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includable in income and assessed a 10 percent penalty tax. Account owners, typically parents and grandparents, can change the designated beneficiary of a 529 plan at any time. While there is no federal income tax deduction for contributions made to a 529 plan, many states offer one or more incentives to participate in their plan. These incentives may include a state income tax deduction for contributions, limited contribution matches for families below proscribed income levels, or an exclusion of 529 plan assets in the calculation of eligibility for state financial aid programs.

A relatively new college savings device, Coverdell Education Savings Accounts, was originally authorized by Congress in 1997 and significantly expanded by tax legislation enacted in 2001. Coverdell accounts, like 529 plans, are funded with after-tax contributions, and the earnings are federal income tax-free if the withdrawal is used for higher education expenses.[5] Unlike 529 plans, there are income limits on who can fund Coverdell accounts,[6] and the Code limits contributions to a maximum of $2,000 per year. While account owners of 529 plans are prohibited from directing the investment of their funds (other than selecting among the plans), Coverdell account owners have significant investment latitude. Coverdell accounts can be invested in mutual funds or individual stocks and bonds, for example. Like the owners of 529 plans, Coverdell account owners can change the designated beneficiary at any time.

One of the earliest college savings devices is the income tax exclusion for interest on Series EE and Series I Treasury bonds. This provision, added to the Code in 1988, allows families to cash in their Treasury bonds to pay college expenses without paying income tax on the accrued interest on the bond. To qualify for the exclusion, certain rules of ownership must be met. In 2003, the interest income exclusion will be phased out for single taxpayers with adjusted gross income between $58,500 and $73,500 while joint returns lose an increasing share of the exclusion as their income increases from $87,750 to $117,750.

Another provision, added to the Code in 1997, allows individuals to withdraw funds from their qualified retirement plans (such as a 401(k), IRA, or 403(b) plan) before reaching age fifty-nine and one-half without paying the extra 10 percent penalty tax, as long as the withdrawal was used to pay certain higher education expenses. This penalty-free IRA withdrawal is still subject to income tax. However, the account owner still benefits from the deferral of income tax on the funds in the account.

When Congress created Roth IRAs in 1997, it added a new type of retirement plan to the mix. In certain cases, funds held in a Roth IRA can be used to meet college expenses, while receiving the tax benefit extended to all Roth IRA plans. Like 529 plans and Coverdell education savings accounts, Roth IRAs are funded with after-tax contributions,

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[5] Coverdell accounts also may be used for certain elementary and secondary educational expenses, including tuition at a private school, tutoring, and other expenses.

[6] For individual taxpayers, the contribution phase-out range is $95,000 to $110,000. For joint returns, the range is $190,000 to $220,000.

but the earnings in a Roth IRA are generally not taxed when withdrawn. The Code imposes income limitations on who can contribute to Roth IRAs,[7] and the annual contribution limit is $3,000 ($3,500 for individuals age fifty or higher). Roth IRAs provide investment flexibility to college savers who can meet the tax-free withdrawals criteria – reaching age fifty-nine and one-half – when they need funds to help defray college costs. For example, grandparents wishing to save for a grandchild's educational expenses may use a Roth IRA as the vehicle; the account receives similar tax treatment to section 529 plans and Coverdell education savings accounts, but the funds may be spent for any purpose, including the grandparents' retirement if the funds are not needed for a grandchild's education.

The Uniform Gift to Minors Act (UGMA) and its successor, the Uniform Transfers to Minors Act (UTMA), are model laws developed by the National Conference of Commissioners on Uniform State Laws. The model laws, first drafted in 1956, have been adopted by all fifty states, and provide a legal structure that allows individuals to irrevocably give securities and many other types of property to a child. UGMA and UTMA allow individuals to contribute to a custodial account in a minor's name without having to establish a trust or name a legal guardian. An adult (usually a parent or grandparent) serves as custodian of the UGMA/UTMA account and is responsible for investing and managing the assets. The child is the "beneficial owner," meaning the assets really belong to the child, not to the adult. Generally, beneficial owners of UGMA accounts gain full control over the asset at age eighteen, while beneficial owners of UTMA accounts gain control at age twenty-one. There is no limit on the amount that can be invested in an UGMA or UTMA account (although gifts from an adult to a minor of greater than $11,000 per year are subject to gift tax). UGMA and UTMA accounts can offer tax-saving benefits as well. To start, while the child is under the age of fourteen, the first $750 in earnings on these accounts is tax-free. Investment earnings between $750 and $1,500 are taxed at the child's rate. Any unearned income above $1,500 is taxed at the parent's top marginal tax rate. When the child reaches age fourteen, the investment income (in its entirety) is again taxed at the child's rate. Finally, UGMA and UTMA funds are not limited to assisting with higher education expenses. While the account is under the custodian's control, withdrawals can be used to pay for special expenses that will benefit the child.

Tax Benefits for Tuition

Beginning in 1998, taxpayers became eligible for two new tax credits – the HOPE and Lifetime Learning tax credits. These credits serve different purposes, provide different levels of tax benefits, and have different eligibility rules. The HOPE credit cannot exceed $1,500 per year[8] for each student and is limited to certain expenses paid for the first two

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[7] In 2002, eligibility to contribute to a Roth IRA was phased out for single taxpayers with an adjusted gross income (AGI) between $95,000 and $110,000 and for joint returns with AGI between $150,000 and $160,000.

[8] The HOPE credit is equal to 100 percent of the first $1,000 of qualifying educational expenses and 50 percent of the next $1,000. A taxpayer may claim more than one HOPE credit on a tax return, provided that more than one individual (the taxpayer, his or her spouse, or a dependent) meets the qualifications.

years of postsecondary education. The Lifetime Learning tax credit can be claimed anytime a taxpayer, or his or her dependent, has qualifying college expenses, including job-training expenses. In 2003, taxpayers receive a 20 percent credit for the first $10,000 in qualifying educational expenses for a maximum credit of $2,000. Only one Lifetime Learning tax credit may be claimed on a tax return, but it may be claimed for more than one individual's qualifying educational expenses.[9] Neither tax credit is refundable, meaning that taxpayers would not receive a tax refund if the amount of their education credits exceeded their income tax liability.

In 2001, Congress created a temporary tuition deduction that supplements the HOPE and Lifetime Learning tax credits. The tuition deduction will be available during tax years 2002 through 2005. It is available to taxpayers regardless of whether they claim the standard deduction or itemize their deductions on Schedule A. In 2002 and 2003, individuals may deduct up to $3,000 in certain college expenses (generally the same expenses that are eligible for the HOPE and Lifetime Learning tax credits). The full deduction is available to single taxpayers with adjusted gross incomes (AGIs) of up to $65,000 and to couples filing a joint return with an AGI of up to $130,000. For 2004 and 2005, the maximum deduction will increase to $4,000, and a more limited deduction (up to $2,000) will be available for single taxpayers with AGIs between $65,000 and $80,000 and joint returns with AGIs of between $130,000 and $160,000.

Generally, amounts given from one individual to another in excess of $11,000 during a year are subject to a gift tax. The gift tax imposes a graduated tax rate that ranges from 18 percent to 35 percent. The gift tax rules include an unlimited exclusion for gifts made to cover the tuition expenses of another individual.[10] The exclusion from gift tax for tuition covers any amounts paid not only by a student's parents but also by other family members (such as grandparents), or for that matter, any other individual.

Employees who receive tuition benefits from their employer can receive such assistance without having to pay income tax on the benefit in a variety of ways. For example, section 127 of the Code allows employer-provided educational assistance of up to $5,250 per year to be excluded from tax.[11] Similarly, employees of educational institutions may exclude tuition benefits they receive, either for their own education or for the education of a member of their family, under section 117 of the Code. Finally, section 132 of the Code allows an employee to exclude job-related education if it meets certain strict tests.

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9 In other words, all of the qualifying educational expenses of the taxpayer, his or her spouse, and any dependents during the year are pooled and may be claimed as a single credit, subject to the $10,000 cap.

10 Section 529 plans also have special gift tax rules that allow contributors to spread their contributions out over a five-year period, for purposes of determining whether the contributions are subject to the gift tax. Thus, an individual could contribute as much as $55,000 to a beneficiary's 529 plan in a single year without paying gift tax. (Any further gifts during the following four years would, however, be subject to tax.)

11 Section 127, last extended by Congress as part of the Economic Growth and Tax Relief Reconciliation Act of 2001, expires on December 31, 2010. Unless Congress extends this rule, employer-provided education benefits provided in 2011 will become taxable income, unless they qualify under either section 117 or 132 of the Code.

Tax Treatment of Educational Loans

In 1997, Congress reinstated a deduction for interest paid on student loans. The previous deduction for such interest was eliminated from the Code by the 1986 Tax Reform Act. The proposal adopted by Congress phased the deduction back in over a five-year period. As a result of this change, along with changes made in 2001, students (and in certain cases, parents) may now deduct up to $2,500 per year in interest they pay on student loans. The deduction is used to calculate the taxpayer's AGI; thus, it is available regardless of whether or not the taxpayer itemizes deductions. The deduction is phased out for single taxpayers with AGIs between $50,000 and $65,000. For joint returns, the deduction is phased out at income levels between $100,000 and $130,000.

In 1982, Congress added a rule to the Code that excludes from a student's income the value of any student loans that are forgiven. This student loan forgiveness rule has certain conditions that 1) restrict the type of loans eligible for this treatment to those issued by the federal or state governments and by educational institutions; and 2) restrict the reasons for which the loan was forgiven to cases where the student performs certain jobs (typically public or community service work).

Federal Financial Aid Programs – An Overview

Several federal programs authorized by the HEA provide financial aid to students attending college. This federal aid may be provided through a combination of grants, loans, and work-study funds. Federal financial aid may also be packaged with aid offered by states, from institutional resources, or from other private sources.

To be eligible to receive most federal financial aid, a student must demonstrate financial need under formulas prescribed by law. For purposes of receiving federal aid, "financial need" is the difference between a student's total cost of attendance and the family resources that are reasonably available to meet these costs (the "expected family contribution" or EFC). Put another way, if a student's cost of attendance is greater than his or her EFC, that student is considered to have financial need and is eligible to receive one or more forms of financial aid.

For most students, the cost of attendance includes the following expenses: 1) tuition and fees; 2) an allowance for books, supplies, transportation, and certain other expenses (including the cost of renting or purchasing a computer); and 3) an allowance for room and board. In addition to basic components, several other expenses may be included in certain students' cost of attendance. First, students with dependents receive an allowance for certain dependent care. Second, students with a disability receive an allowance for special services, transportation, equipment, and personal assistance. Third, students who participate in a cooperative education program receive an allowance for certain costs associated with their employment. Fourth, students who study abroad may receive an allowance for the costs associated with their program.

Each student seeking federal financial aid must complete an application, the Free Application for Federal Student Assistance, or FAFSA. The information submitted on the FAFSA is used to

Figure 3: FAFSA Calculation of Parents' Available Income

Parents' Available Income = Total Income - Parental Allowances

Total Income

Parent's Adjusted Gross Income

plus

- Earned Income Tax Credit
- Child tax credit(s)
- Certain welfare benefits
- Tax-free Social Security benefits
- Employer and employee payments to retirement savings plans
- Tax-deductible IRA, SEP, Simple, and Keogh plan contributions
- Child support payments received
- Tax-free interest income
- Tax-free foreign income
- Tax-free IRA distributions (excluding rollovers between plans)
- Tax-free pension distributions
- Certain housing and living allowances
- Certain veterans benefits
- Tax-free workers' compensation, disability benefits, and any other type of tax-free income

minus

- Education tax credits claimed
- Child support payments
- Taxable earnings from College Work-Study, and taxable student aid (including AmeriCorps Awards) included in AGI

Parental Allowances

- An allowance for federal income taxes (equal to amount shown on tax return)
- An allowance for state taxes (equal to a percentage of total income; the specific percentage is based on state of residence and amount of total income)
- An allowance for Social Security and Medicare taxes paid by parents
- An "income protection" allowance (determined according to the number of individuals, and the number of college students, in the household)
- An "employment expense" allowance (a percentage of earned income, not to exceed $3,000)

calculate his or her EFC. ED is responsible for processing each FAFSA submitted and for producing a Student Aid Report (SAR). The SAR contains the student's EFC and other data. Colleges and universities use it to develop a financial aid "package" for enrolled students.

To calculate the EFC the HEA provides three formulas–one for dependent students,[12] one for independent students without dependents (other than a spouse), and one for independent students with dependents (other than a spouse). In addition to these three formulas, the law also provides a simplified formula for individuals who meet certain criteria, and an "automatic zero EFC" rule for families whose income does not exceed $15,000.

[12] The rules for determining whether an individual is a dependent student for purposes of federal financial aid are not the same as those used for federal income tax purposes.

Calculating the EFC for Dependent Students

The EFC for dependent students comprises three elements: 1) the parents' contribution; 2) the student's contribution from income; and 3) the student's contribution from assets. The parents' contribution is determined by weighing three factors: their available income, their contribution from assets, and the number of dependents in college. The parents' available income is the sum of their total income, which includes certain taxed and untaxed income and benefits, less certain parental allowances provided by the formula (see Figure 3).

Once the parents' available income has been calculated, it is combined with the second factor – the parents' contribution from assets. The formula considers that a portion of the parents' assets is available to meet the family's college expenses and sets out rules to determine what assets should be reported on the FAFSA.

Parent assets include cash as well as all their savings and checking accounts. Assets also include most investments, such as mutual funds, money market accounts, stocks, bonds, and certain real estate holdings. They do not include pension and retirement plan assets. Under the formula, the family's principal place of residence is not reported as an asset, nor is a farm if that is the family's residence and certain other conditions are met.[13] Other real estate, such as rental property owned by the family, is generally considered as an asset.

Family-owned businesses are generally considered an asset for purposes of the formula. Where a family owns a business, the net worth of such holdings are used in the formula (e.g., the fair market value of the business, including its land, buildings, equipment, and inventories, minus any debt held to acquire or improve business assets).

Once the value of all assets is determined, the formula provides a subtraction for an asset protection allowance. This allowance, which ranges from $0 to more than $68,000, varies, depending on the age of the older parent and whether the student comes from a household with one or two parents. After subtracting this allowance from the parents' net worth, the formula adds 12 percent of the revised total to the parents' available income. This total, referred to as the parents' "adjusted available income," is then subject to a progressive rate schedule, ranging from 22 percent to 47 percent, to determine the total parental contribution.

The third factor in determining the parents' contribution is the number of children in college. The parents' contribution for the individual student is calculated by dividing the total parental contribution by the number of children (but not parents) attending college.

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[13] The family must claim, for federal income tax purposes, that it "materially participated in the farm's operation" (see Schedule F of Form 1040). In certain cases, if a family farm has been incorporated (thus, no Schedule F is filed with the IRS), the family must be able to show that they reside on the farm, and that the family owns all the shares of stock in the corporation, in order to exclude the farm as an asset.

Calculating the EFC for Independent Students Without Dependents (Other than a Spouse)

The EFC for independent students without dependents (other than a spouse) comprises two elements: 1) the student's available income; and 2) the student's contribution from assets.

The student's available income is the sum of his or her total income, which includes certain taxed and untaxed income and benefits, less certain allowances provided by the formula. Generally, a dependent student's available income and assets are calculated using a method similar to that used to calculate parental income and assets. The formula differs for independent students in that it applies different allowances and schedules and assesses a higher percentage of assets as being available to pay for college costs (35 percent).

Calculating the EFC for Independent Students with Dependents (Other than a Spouse)

The EFC for independent students with dependents (other than a spouse) similarly comprises two elements: 1) the student's available income; and 2) the student's contribution from assets.

The student's available income is the sum of his or her total income, which includes certain taxed and untaxed income and benefits, less certain allowances provided by the formula. Generally, a student's available income and assets are calculated using similar methodology to that used to calculate parental income and assets for dependent students. The formula makes an adjustment for the number of students in the household attending college.

The Simplified Formula

The simplified formula used to calculate the EFC is essentially the same as the formulas described above, with one notable exception: asset information is not included in the calculation. In order to be eligible for this simplified formula dependent students must meet the following requirements: 1) neither the student nor his or her parents were required to file a Form 1040;[14] and 2) the parents' AGI was less than $50,000 (for parents that do not file a tax return, earned income must be less than $50,000). Similar rules apply to independent students: neither the student nor his or her spouse was required to file a Form 1040, and the combined AGI (or earned income for persons who did not file) of the student and spouse cannot exceed $50,000.

While the law provides this simplified formula, students and parents who complete the FAFSA are unlikely to be aware of its existence. All students and parents are instructed to complete the sections of the FAFSA that collect asset information. Under current procedures, when the FAFSA is processed, the resulting SAR will contain a single EFC that excludes the asset information (assuming that the student is eligible for the simplified

[14] An exception to this requirement applies where the Form 1040 was filed solely to claim an education tax credit.

formula based on the information submitted on the FAFSA). However, states and institutions of higher education have access to both the EFC and the FAFSA data, including the asset information submitted by the student. States and educational institutions may use the asset information reported by the student in awarding their own aid.

The "Automatic Zero EFC" Rule

For federal financial aid purposes, a student is not expected to contribute toward the cost of attending college if neither the student nor his or her parents were required to file a Form 1040, and if the parents' combined adjusted gross income (for parents that were required to file an income tax return) is $15,000 or less. For parents who are not required to file an income tax return, their combined earned income must be $15,000 or less. Independent students with dependents other than a spouse are also eligible for this rule if they meet similar requirements. Independent students with no dependents other than a spouse are not eligible for the automatic zero EFC rule.

How Tax Benefits and Federal Financial Aid Programs Interact

Since the process used to determine eligibility for federal student financial aid, referred to as "need analysis," relies heavily on data from applicants' tax returns, the tax treatment of college savings accounts, tuition payments and benefits, and student loan payments is inextricably part of the process used to determine financial aid eligibility. However, as Figure 4 illustrates, the current rules and guidelines governing how these various tax provisions are treated for purposes of Title IV financial aid are often inconsistent and in many cases unclear enough to raise serious questions about how these benefits and amounts are being reported by applicants for federal financial aid.

For example, among the three principal college savings options (529 plans, Coverdell education savings accounts, and Treasury EE bonds), these tax-preferred accounts are assessed (that is, some portion of the value of the account is determined by formula to be available to pay college expenses) at rates ranging from 2.64 percent to 100 percent. Each of these accounts, with the exception of Treasury EE bonds, may be held by a student's grandparents and thereby escape reporting on the FAFSA (and thus effectively be assessed at a rate of zero percent). Treasury EE bonds must be redeemed by a parent for his or her own education or for that of a dependent, in order to be eligible for the interest income exclusion.

Although a number of these tax provisions were enacted since the last HEA reauthorization in 1998, neither Congress nor ED has been able to fully clarify how families should treat these various programs since they were enacted. In the HEA reauthorization, Congress should consider adopting rules that would apply not only to existing tax provisions but also to any new ones that might be created in the years between reauthorizations. The need for some flexibility is apparent – the temporary tax deduction for tuition expires on December 31, 2005, and proposals have already been made to expand the deduction. Alternatively, some have suggested that the deduction

Figure 4: Interaction Between Tax Benefits and Federal Need Analysis of Parents' Available Income

Provision	Impact on AGI	Treated as an Asset?	Assessment Rate	Added Back on FAFSA?
Savings Incentives				
529 Savings Plan	Contributions to a plan do not change AGI. Qualified withdrawals reduce AGI by the amount of interest income excluded.[a]	Yes, if the account owner is either a parent or student, but FAFSA instructions do not provide clear guidance about how to report.	If reported as a parental asset, assessed at a maximum rate of 5.64 percent; if reported as a student asset, assessed at a 35 percent rate.	No
529 Prepaid Plan	Contributions to a plan do not change AGI. Qualified withdrawals reduce AGI by the amount of interest income excluded.	No, plan redemptions reduce a student's cost of attendance, irrespective of who owns the account.	100 percent	No
Treasury EE Bonds	Neither purchases nor qualified redemptions directly change AGI.	Yes, generally as a parental asset[b]	Maximum rate is 5.64 percent.	Yes
Coverdell ESA	Contributions to a plan do not change AGI. Qualified withdrawals reduce AGI by the amount of interest income excluded.	Yes,[c] as a student asset	35 percent	No
Retirement Plans	Employee contributions generally decrease AGI when made.[d] Qualified withdrawals increase AGI.	No	Penalty-free withdrawals increase parental income, which is assessed at rates ranging from 22 to 47 percent.	Both employee and employer contributions are added back on FAFSA.

Figure 4: Interaction Between Tax Benefits and Federal Need Analysis of Parents' Available Income *(continued)*

Provision	Impact on AGI	Treated as an Asset?	Assessment Rate	Added Back on FAFSA?
Savings Incentives				
Roth IRA	Contributions to a Roth IRA do not change AGI. Qualified withdrawals reduce AGI by the amount of interest income excluded.	No	If reported as parental income, they would be assessed at rates ranging from 22 to 47 percent.	Instructions do not provide guidance.[e]
UGMA/UTMA	Interest income increases student's AGI.	Yes	If reported as a parental asset, assessed at a maximum rate of 5.64 percent; if reported as a student asset, assessed at a 35 percent rate.[f]	No
Tuition Provisions				
HOPE Tax Credit	No impact	No	N/A	Yes
Lifetime Learning Tax Credit	No impact	No	N/A	Yes
Tuition Deduction	Reduces AGI by amount of allowable deduction.	No	N/A	Instructions do not provide guidance.
Section 117, 127, and 132 Benefits	Reduces AGI by amount of allowable exclusion.	No	If reported as parental income, assessed at rates ranging from 22 percent to 47 percent; if reported as student income, assessed at 50 percent rate.	Instructions do not provide guidance.[g]

Figure 4: Interaction Between Tax Benefits and Federal Need Analysis of Parents' Available Income *(continued)*

Provision	Impact on AGI	Treated as an Asset?	Assessment Rate	Added Back on FAFSA?
Tuition Provisions				
Gift Tax Exclusion	No impact[n]	No	N/A	No
Student Loan Provisions				
Student Loan Interest Deduction	Reduces AGI by amount of allowable deduction.	No	If reported as parental income, assessed at rates ranging from 22 to 47 percent; if reported as student income, assessed at 50 percent rate.	Instructions do not provide guidance.[l]
Forgiveness of Student Loan Exclusion	Reduces AGI by amount of allowable exclusion.	No	If reported as parental income, assessed at rates ranging from 22 to 47 percent; if reported as student income, assessed at 50 percent rate.	Instructions do not provide guidance.[l]

Notes:

[a] The income portion of a qualified withdrawal is excluded from income. Thus, these plans indirectly reduce the applicant's AGI.

[b] In order to be eligible for the interest income exclusion, the bonds must be purchased by an individual age 24 or older and issued in his or her name. Thus, an individual could use this provision to help finance his or her own education, in which case that individual would almost certainly be considered an independent student for purposes of need analysis.

[c] The instructions that accompany the FAFSA indicate that these accounts should be reported as a student's asset if the account is in his or her name. Since the account owner can change the designated beneficiary at any time (as long as the new beneficiary is a member of the same family, and has not reached age 30), this reporting requirement may be circumvented.

[d] Certain contributions to qualified retirement plans may be made with after-tax income. For these contributions, only the income earned on nondeductible contributions is taxed when amounts are subsequently withdrawn.

[e] The growth in the value of a Roth IRA is untaxed income and thus could be reported on the FAFSA. However, the instructions do not call for this, and it is reasonable to assume that most applicants do not report the "untaxed income" component of any Roth IRA withdrawals.

[f] Whether or not the UGMA or UTMA account is legally considered the student's asset is a matter of state law. Generally, control over UGMA accounts automatically transfers to the beneficiary at age 18, while the transfer of full control over UTMA accounts occurs when the beneficiary turns 21.

[g] While these benefits are arguably "other untaxed income or benefits not reported elsewhere" and hence should be reported on Worksheet B of the FAFSA, the absence of clear instructions and the difficulty an applicant may have in knowing the value of the benefit they received mean that few if any applicants would report this benefit.

[h] Gift tax is paid by the donor and thus is not considered income to the recipient.

[i] While the deduction for student loan interest renders the income used to repay interest "untaxed" (or at least, not subject to federal income tax), applicants may not consider the benefit of the student loan interest deduction in this way and thus may not report the deduction on Worksheet B. The FAFSA instructions are silent on this point.

[j] While the exclusion for forgiveness of student loans is arguably "other untaxed income or benefits not reported elsewhere," without clear instructions, it is unlikely that applicants will know to report this benefit on Worksheet B.

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and the Lifetime Learning tax credit could, in various fashions, be combined. Congress should also insist that the FAFSA and its instructions be clarified so that families will understand how these education tax programs are to be reported and treated for financial aid purposes.

Tax provisions can affect need analysis in three principal ways. First, the tax provision increases or lowers an applicant's AGI, which is used as the starting point for calculating financial need. Examples of this include the new deduction for college tuition and the student loan interest deduction, both of which are "above-the-line" deductions that are used to calculate a taxpayer's AGI. In addition, income exclusions, such as for employer-provided educational benefits as well as for income earned in a college savings account, effectively reduce AGI below what it would have been in the absence of the specific tax provision providing for the income exclusion.

Second, the tax provision increases or lowers an applicant's final tax liability. The HOPE and Lifetime Learning tax credits are examples of this effect. The applicant's federal income tax payment is considered an allowance that reduces the amount of income that is otherwise considered available to meet college expenses.[15] Thus, all other things being equal, reduced federal income tax payments increase the applicant's EFC.

Third, the tax provision is designed to create an asset, such as a college savings account, specifically for the purpose of assisting the taxpayer in paying college expenses. Created by special tax rules, these assets raise a series of policy questions.

Unfortunately, while the economic effects of the various education tax programs can be easily described, there is little uniformity in how these provisions are treated in need analysis, as Figure 4 illustrates.

Policy Options for Tax Policy and Financial Aid Interactions

In order to rationalize how tax policy and federal financial aid programs might not only peacefully coexist but also, to the extent possible, be consistent with one another, it is useful to have a set of goals and to offer a yardstick of sorts to help assess whether or not these rules are functioning harmoniously. Four overarching goals ought to be integral to the relationship between tax and financial aid policy. These goals are that, to the maximum extent possible, there ought to be 1) consistency in how programs interact, 2) clarity in how tax provisions are considered in the aid allocation formula, 3) equity in impact, and 4) simplicity in reporting.

These goals are not mutually exclusive. As noted earlier, the current integration of tax and financial aid rules strays far from the goal of program consistency. The oft-cited example of the disparate treatment of prepaid tuition plans and 529 education savings plans

[15] Tax provisions that reduce an applicant's AGI also reduce an applicant's tax liability. Thus, these provisions have an impact on the distribution of student aid in two distinct ways.

demonstrates how one type of asset can be assessed in diametrically opposite ways. These widely varying rules, among others, erode program equity, and the uncertainty of how 529 savings plans should be reported on aid applications reduces program clarity. On the other hand, attempting to meet one of these goals may work at cross-purposes with efforts to meet others. For example, obtaining consistent treatment may significantly complicate the financial aid application process. Striking a balance between and among these various objectives should be the goal of the HEA reauthorization process.

In order to help organize these program interactions, it is useful to group program interactions into three sets on the basis of how they affect the allocation of financial aid: 1) those that directly change an applicant's AGI; 2) those that directly change the applicant's final tax liability; and 3) those that create an asset.

Under this organization, five tax provisions in the current law would fall into the group that has a direct impact on AGI. These provisions are the temporary tuition deduction, employer-provided education benefits, the student loan interest deduction, the treatment of withdrawals from retirement plans, and the exclusion for student loan forgiveness. Two tax rules have a direct impact on an applicant's final tax liability – the HOPE and Lifetime Learning tax credits. Finally, a variety of provisions, including the various savings incentives, fall into the third category, since each provision leads to the creation of an asset that may be available to meet college expenses.

The first philosophical question facing policymakers is how to respond to these tax provisions in crafting the formula to allocate federal financial aid. Conceptually, there are several possible responses – the tax benefit could be augmented, ignored, neutralized, or recaptured in the aid formula.

For example, consider an applicant who had accumulated $5,000 in a Coverdell education savings account. Aside from the tax advantages inherent in maintaining a Coverdell account, policymakers could "reward" saving for college by augmenting the account in needs analysis. There are various ways of accomplishing this, one of which would be to reduce the applicant's EFC by an amount equal to some portion of his or her Coverdell account balance.

Another option would be to ignore the asset or tax benefit by excluding it from the formula. Proposals have already been made to exclude 529 plans from the asset calculations, for example. As described earlier, the current design of the FAFSA and its instructions serve to exclude a variety of tax provisions and their benefits from need analysis.

Finally, the account could be neutralized or recaptured to some degree by requiring that it be factored into need analysis. Congress has several tools to accomplish this objective. When a tax provision reduces an applicant's AGI, Congress could require that the amount of the tax deduction (or exclusion) be added back on the FAFSA to reduce the impact of the tax provision on an applicant's eligibility for financial aid. For example, Congress could require that the deduction for student loan interest claimed by applicants on their tax returns be reported on the FAFSA and added back to their AGI. This type of

adjustment, however, only partially neutralizes the interaction. While the adjustment increases the applicant's AGI to account for the student loan interest deduction in this example, it does not account for the reduction in tax liability that the deduction caused. For example, consider parents in the 27 percent bracket who were eligible to claim a deduction for $1,000 in student loan interest they paid during the year. The deduction reduces their AGI by $1,000 and, as a result, lowers their tax liability by $270. To fully neutralize this two-step interaction, applicants would have to calculate their actual tax savings for any deductions or exclusions they claimed and add that amount to their actual federal income tax payment. Such a calculation could be relatively complex, particularly for taxpayers who benefited from more than one provision or who moved between tax brackets as a result of these provisions.

When a tax provision directly reduces an applicant's tax liability, the reduction can be added back on the FAFSA. The HOPE and Lifetime Learning tax credits are examples of this type of treatment under current law. In these examples, the tax benefit can be factored into the formula because the value of the credit is readily determined by the applicant, simply by referring to a specific line on the tax return.[16]

When a tax provision is designed to create an asset, the policy response raises more complex questions – not only how to handle the asset itself but also how to handle its impact on an applicant's tax return. An example of this policy conundrum may be found in the treatment of 529 plans. When 529 plans are redeemed to pay college expenses, the interest income is excluded from tax, thereby reducing the applicant's AGI and final tax liability. Irrespective of whether (or how) the financial aid formula treats the plan as an asset, the tax treatment of 529 plans serves to increase an applicant's eligibility for financial aid.[17]

These policy questions can also become complex because tax provisions have indirect effects on need analysis. They are designed to cause a shift in the composition and allocation of a family's assets or income stream, relative to the economic decisions that would have been made in the absence of a particular tax provision.

Congress will not be making decisions about how these specific tax rules ought to interact with federal financial aid programs in a vacuum. For example, the treatment of education-specific assets, such as section 529 plans, will occur amid a broader discussion of the proper treatment of all family assets. Nonetheless, the connection between these two sets of policy discussions may be tenuous, at least with regard to how Pell Grants are allocated. In the 2000–01 award year, more than 93 percent of Pell Grants were awarded to students who

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[16] The current FAFSA treatment of the education tax credits, perhaps unavoidably, is imprecise. Aid applicants are asked to include the amount of the credit claimed on the most recent tax return. However, the amount claimed may not equal the benefit received by the taxpayer, since the value of the taxpayer's total credits (including the child credit, child care expenses credit, and others) may exceed their tax liability. In such a case, the value of each of the credits is ratably reduced to match the payer's tax liability prior to claiming these tax credits.

[17] The impact of the reduction in AGI will always exceed the impact of the reduced tax liability, since the reduction in tax liability is a fraction of the lower AGI, with the fraction equaling the taxpayer's marginal tax rate.

reported less than $7,500 in net assets. Approximately two-thirds of all Pell Grants were awarded using formulas that excluded consideration of assets in determining financial aid eligibility. Taken together, the data suggest that for most students, whether or not section 529 plans, Coverdell accounts, or any other tax-advantaged savings plans are considered assets in need analysis is unlikely to make a significant difference in Pell Grant eligibility. This comes as little surprise: Pell Grants are distributed to students from low-income families who have little opportunity to accumulate assets or benefit from tax incentives designed to encourage such savings. As long as the need analysis formula continues to exclude consideration of assets for large portions of low- and moderate-income families and students, the presence of education tax programs that generate assets will not have a large impact on Pell Grant eligibility.

With respect to determining eligibility for student loans, particularly determining whether or not a student is eligible for subsidized or unsubsidized Stafford loans, the treatment of assets may have a somewhat greater impact. Approximately one-quarter of subsidized Stafford loans are made to borrowers with AGIs in excess of $50,000. At this income level, the student no longer qualifies under current law for either the automatic zero EFC formula or the simplified formula; thus, assets must be reported on the FAFSA and included in the calculation of the student's EFC. Similarly, more than 40 percent of unsubsidized loans are made to borrowers with AGIs greater than $50,000. Families with incomes above $50,000 are more likely to have accumulated assets to help pay college expenses than families with lower incomes. Among Pell Grant recipients, about 6 percent of those with family incomes of less than $50,000 reported assets of more than $7,500. Among those with family incomes of more than $50,000, almost 19 percent reported assets of more than $7,500.

On the basis of available data, it appears that the treatment of education tax programs that generate assets to meet educational expenses is more likely to have an impact on eligibility for federally guaranteed student loans than for Pell Grants.

Efforts to quantify the precise impact of these education tax programs are complicated by the lack of publicly accessible data on this topic from the Internal Revenue Service (IRS) and, to a lesser degree, from ED. Some of these data simply are not collected, some of these programs are too new to have generated any significant data, and some data are not compiled and reported in a way that would lend itself to analysis of these questions. While a specific tax provision delivers a particular benefit, the process of understanding the consequences of different options for reporting and incorporating that provision into the need analysis formula is unnervingly speculative. Congress would be well served to have access to the best data and analysis available from ED and the IRS.

During the HEA reauthorization, policymakers will find themselves in the difficult position of considering one central trade-off, which in turn generates several others. Ultimately, policymakers must choose between streamlining the aid application process (which argues for ignoring these education tax programs) and adding complexity to the process by developing a series of rules to factor these tax benefits into the process of awarding federal student financial aid. Some of the policy choices are summarized in Figure 5.

Figure 5: Trade-Offs in Changing the Aid Application Process

Complexity		Simplicity	
Advantages	***Disadvantages***	***Advantages***	***Disadvantages***
Rules can be developed that attempt to target federal financial aid.	Difficult to "capture" some of the tax programs, even with complex rules.	Application process is streamlined.	Less precise targeting of federal financial aid.
Rules can attempt to ensure that tax benefits are treated consistently and equitably.	Bringing tax benefits into the formula raises timing issues (use of tax benefits in one year has an effect on financial aid the following year when tax benefits may or may not be available).	Fewer rules can enhance clarity of aid application process.	Students could receive aid that exceeds their total costs of attending college.

Policymakers may be tempted to require the reporting of these tax benefits, or some subset of them, on the FAFSA to ensure that a complete and fair economic profile of the applicant is presented and considered in the various aid formulas. (See flowcharts, Figure 6 and Figure 7, found at the conclusion of this chapter for a guide to making this determination.) According to congressional estimates, the seven major education tax changes added to the Code since 1996 will reduce federal income tax collections by $8.5 billion in FY 2003. The federal government provided almost $54.5 billion in direct financial assistance, including more than $37.9 billion in student loans, during FY 2002. By any measure, these tax provisions are significant enough to warrant attention.

Reporting all these various benefits on the FAFSA will require a significant reworking of the form and its instructions. Such a process is likely to improve the form and make it more useful for students and families. The current instructions are complicated and leave many questions unanswered.

Incorporating all of these tax benefits in the aid formula could make the application and instructions considerably more complex. Perhaps more important, the operation of the tax provisions can make it difficult to capture the information uniformly and, some may argue, fairly. For example, a 529 plan opened by a parent for his or her child could be considered an asset for aid purposes, but in another family in similar economic circumstances, the 529 plan could be opened by the child's grandparents. From an economic perspective, the two students should be eligible for similar amounts of aid. However, if Congress adopts rigid rules for treating these assets that do not reflect the latitude that the tax laws provide to families, serious inequities could result, and confidence in the financial aid programs will be eroded.

Legislators may try to focus on the "low-hanging fruit" by bringing a few of the more significant education tax programs into student financial aid formulas. For example, the rules regarding section 529 plans could be clarified and updated, reflecting the popularity of these college savings plans. While these plans may be popular (families are placing more of their college savings dollars into them than into any other program), if families and their financial advisors find that one form of savings enjoys particular advantages, or disadvantages, over others, the market for college savings devices will adjust to the new rules. In addition, confidence in and support for financial aid programs will suffer if there is a widespread perception that the programs are somehow biased for or against other federal programs.

While this argues for uniform treatment of all forms of tax-advantaged college savings plans, such uniform treatment will be difficult, if not impossible, to achieve. One reason is the basic operation of the tax program – for example, a grandparent may be the owner of a 529 savings plan and may change the designated beneficiary of that account at his or her discretion. This configuration of tax rules makes "assigning" the 529 plan asset to a particular student, or even a specific family, for purposes of student financial aid programs, problematic. Even if Congress decides to assign a 529 plan to a particular student, it also needs to determine what the proper payout rate should be. Tax rules

impose a penalty tax on amounts held in 529 plans and Coverdell accounts that are not used for educational expenses (and the income exclusion is forfeited). Considering these assets in financial aid calculations will require that only a small fraction be paid out, a fact that has led some to suggest that financial aid rules should have a separate category for these tax-advantaged savings plans, with rules that are different from those for other types of family assets.

More broadly, while the threshold question facing policymakers may be whether or not to include these education tax programs in need analysis, numerous, and thorny, questions arise about how education tax programs could be incorporated in a way that would appropriately balance the four goals of consistency, clarity, equity, and simplicity in how they are reported and factored in the formulas.

Given the complex policy issues that are raised when one seeks to account for the multitude of education tax programs in student financial aid programs, policymakers will be tempted to consider the advantages of ignoring these education tax programs. In such a case, families would correctly perceive that their efforts to save for college costs were not somehow being penalized by the financial aid system. However, ignoring these programs restricts the ability of policymakers to target limited federal financial aid dollars to students who demonstrate the greatest need, and it could allow students to receive combined federal benefits (direct student aid, federally backed student loans, and tax benefits) that far exceed their total cost of college attendance.

Congress can exclude consideration of these tax programs in federal financial aid only if it can reach two important conclusions. First, it must determine that if these programs are excluded from aid formulas, eligibility for student aid – loans in particular – will not be altered in any significant way. The data suggest that such a policy would not significantly alter the Pell Grant program; further examination of borrowing data would be in order. Second, Congress needs to determine that such an exclusion would not allow students to receive greater aggregate benefits than their educational expenses.

The decisions will be made against a backdrop of even greater public focus and attention than normal. With the enactment of these education tax programs, financial aid recipients and families planning how they will meet their future educational expenses are focused more than ever on how tax rules and financial aid programs interact. Due to the complexity of the education tax rules, particularly with respect to how various rules can be used simultaneously, families will be particularly interested in any efforts to simplify current rules governing the interactions between tax and financial aid policy.

The signals that Congress sends to students and families in the upcoming reauthorization will be important ones – particularly with respect to how incentives to save for higher education are to be handled. So, too, will the directions the Congress provides to ED in terms of how to properly administer the financial aid application process. As policymakers begin making these critical decisions, they will need to assemble the best data and analysis available and prepare themselves to make some difficult choices.

Figure 6: Deciding Whether Or Not Tax Provisions that Impact AGI or Tax Liability Should be "Added Back" on the FAFSA

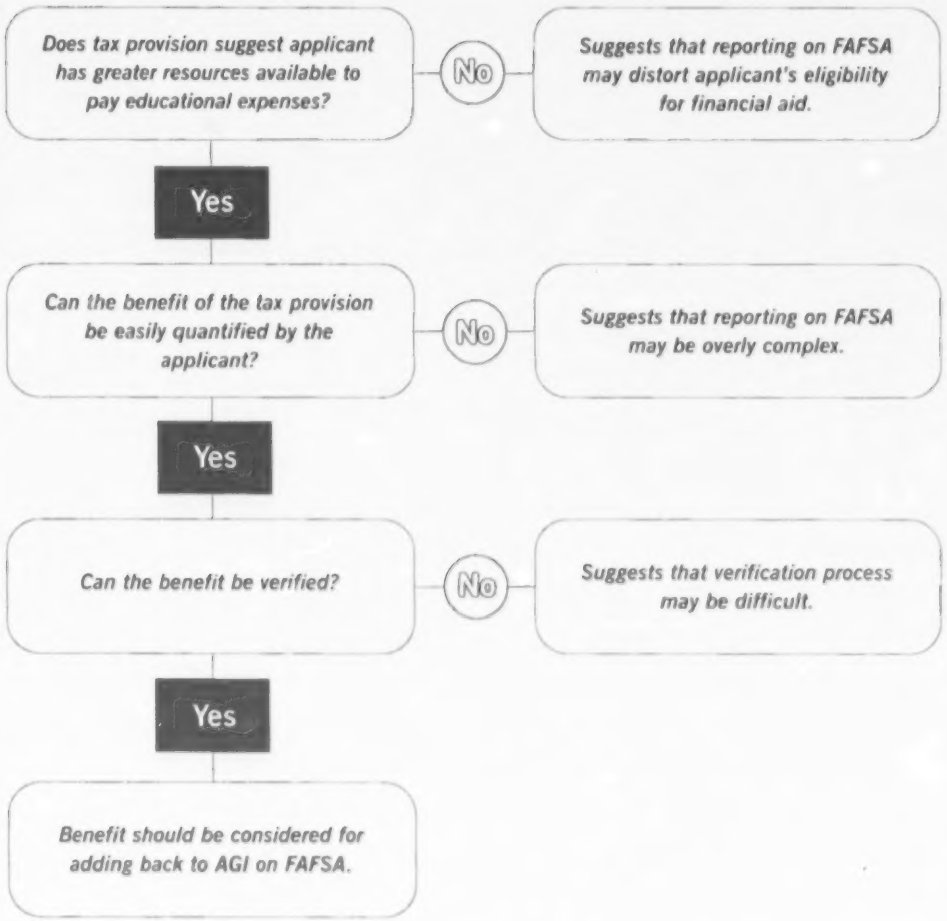
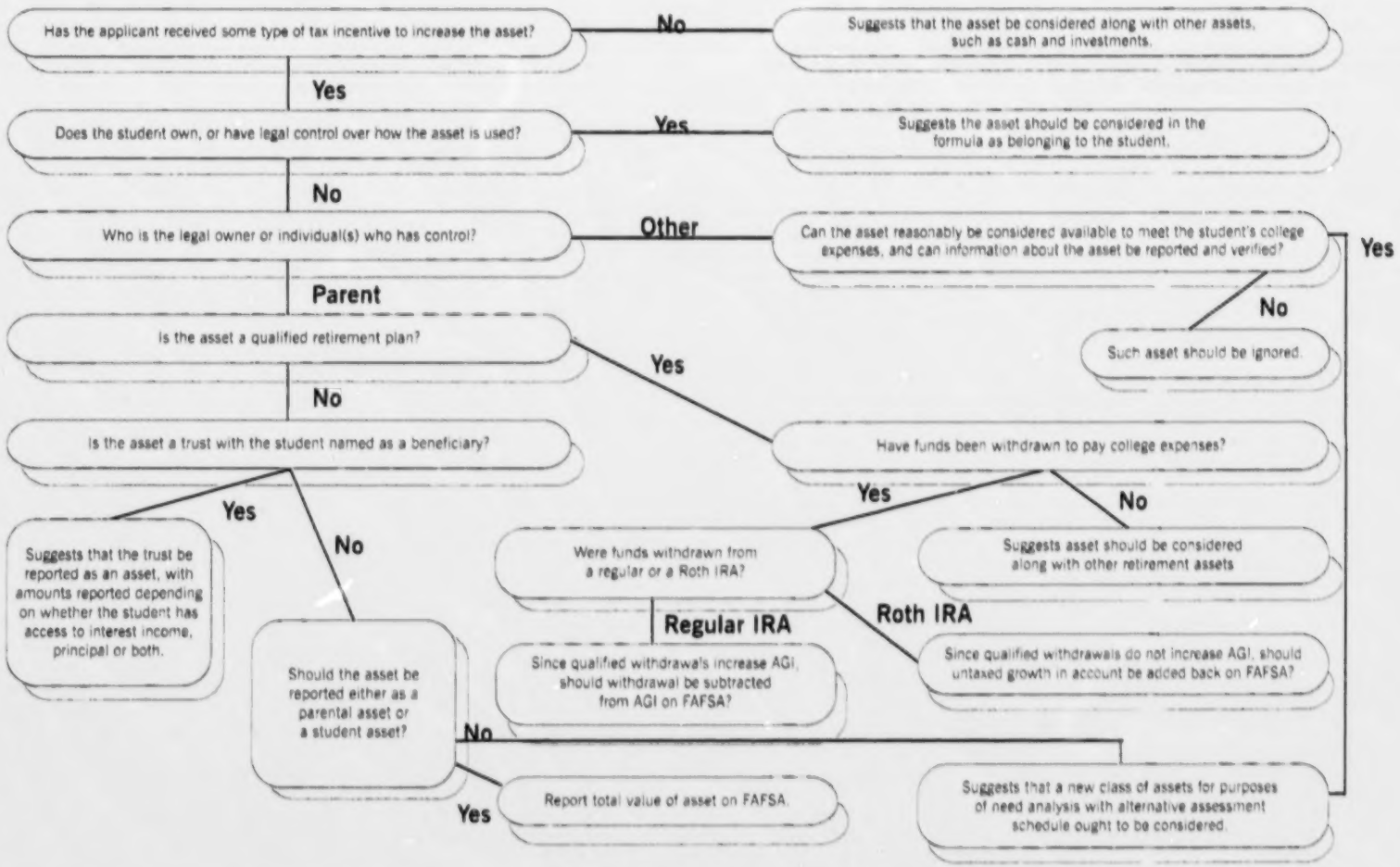

Does tax provision suggest applicant has greater resources available to pay educational expenses?
No
Suggests that reporting on FAFSA may distort applicant's eligibility for financial aid.
Yes
Can the benefit of the tax provision be easily quantified by the applicant?
No
Suggests that reporting on FAFSA may be overly complex.
Yes
Can the benefit be verified?
No
Suggests that verification process may be difficult.
Yes
Benefit should be considered for adding back to AGI on FAFSA.

Figure 7: Determining the Proper Needs Analysis Treatment of Assets Accumulated with the Assistance of Tax Incentives


Has the applicant received some type of tax incentive to increase the asset?
No
Suggests that the asset be considered along with other assets, such as cash and investments.
Yes
Does the student own, or have legal control over how the asset is used?
Yes
Suggests the asset should be considered in the formula as belonging to the student.
No
Who is the legal owner or individual(s) who has control?
Other
Can the asset reasonably be considered available to meet the student's college expenses, and can information about the asset be reported and verified?
Yes
No
Such asset should be ignored.
Parent
Is the asset a qualified retirement plan?
Yes
No
Is the asset a trust with the student named as a beneficiary?
Have funds been withdrawn to pay college expenses?
Yes
No
Yes
No
Suggests that the trust be reported as an asset, with amounts reported depending on whether the student has access to interest income, principal or both.
Were funds withdrawn from a regular or a Roth IRA?
Suggests asset should be considered along with other retirement assets
Regular IRA
Roth IRA
Since qualified withdrawals increase AGI, should withdrawal be subtracted from AGI on FAFSA?
Since qualified withdrawals do not increase AGI, should untaxed growth in account be added back on FAFSA?
Should the asset be reported either as a parental asset or a student asset?
No
Yes
Report total value of asset on FAFSA.
Suggests that a new class of assets for purposes of need analysis with alternative assessment schedule ought to be considered.

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"Where can I sit?"

The capacity of higher education to provide access

Background

As a knowledge–based economy intent on maintaining its economic vitality, the United States requires that its residents acquire increasing levels of education and training. The proportion of future U.S. jobs requiring postsecondary education is estimated to range between 70 and 90 percent. A major policy question facing higher education is whether – and how – institutions of higher education will meet this demand as well as accommodate and educate burgeoning numbers of young people, many of whom are first-generation students from low-income families. For many qualified students, the ability to attend a postsecondary education institution is threatened simply by the lack of appropriate places for them.

- Nationwide, there is not enough classroom space. The number of adult learners, as well as the size of the traditional college-age population, is increasing. The high school graduating class of 2008 is expected to be the largest in history, with almost 3.2 million graduates. This represents an 11 percent increase over the year 2002. Total enrollment, both traditional and nontraditional, in the nation's colleges and universities is expected to increase by 2.6 million (17 percent) between now and 2015. In California alone, it would take more than twenty new colleges, each enrolling 30,000 students, to meet the projected growth in enrollments. Approximately 80 percent of these new students will be racial and ethnic minorities. Existing plans for expanding current facilities and constructing new ones will not provide a sufficient number of places to meet this demand.

- Courses or programs offered through technology-mediated distance learning have not generally proven to be less expensive than comparable courses or programs offered in traditional classroom settings. In general, education technology has been an add-on and an enhancement to educational programs, that is an added expense rather than a lower-cost substitution. Nevertheless some experts believe that an investment in distance learning can improve access to higher education at a lower cost than an investment in bricks and mortar. Some policymakers and advocates of distance learning are concerned that the financial aid requirements under Title IV act as a deterrent to students' ability to take courses and programs at a distance. This would limit the usefulness of distance education as a means of accommodating new enrollments and stifle it as a source of innovation and quality improvement in higher education programs.

- The increase in enrollments in distance education and the possibility that this growth will accelerate in the face of the expected surge in enrollments pose serious

challenges to accreditors. They must attempt to assess the quality of educational institutions and programs that are rapidly changing and that are dramatically different from traditional higher education. The profound alterations in the teaching/learning process may require the federal government to reexamine the ability of the accreditation process to ensure that distance learning providers are meeting quality expectations.

- While distance learning may be one strategy to meet future enrollment demand, it is not cost-free. Many institutions, including Historically Black Colleges and Universities, Hispanic-Serving Institutions, and Tribal Colleges, lack the technical infrastructure to offer distance education courses and programs or to improve quality of instruction through technology. Many analysts observe that an "institutional digital divide" has emerged between large, well-financed institutions and smaller colleges with fewer resources.
- Physical barriers exist for people with disabilities who wish to enroll in postsecondary education along with other barriers impeding their ability to participate in all programs at institutions of higher education. While the numbers of students with disabilities is growing rapidly in higher education, young people with disabilities are still less likely to go on to higher education than nondisabled students, and students with disabilities who start postsecondary education are less likely to finish than nondisabled students. The HEA reauthorization can provide an opportunity to improve the quality of education for this growing, but still underrepresented, group of students.

How does HEA address these issues? What are the limitations and shortcomings in the current treatment of these issues in the HEA? What are the options and trade-offs for changing and improving policy?

Higher Education Facilities

There is a long history of federal involvement in the construction of higher education facilities, beginning with the Land-Grant College Act of 1862. The Housing Act of 1950 created a program of direct government low-interest loans for the construction of college housing. The program was later expanded to include grants to reduce the interest costs on loans to build dormitories. In 1963, the Higher Education Facilities Act (HEFA) authorized grants and loans to institutions for the construction or improvement of libraries and classrooms where science, engineering, mathematics, or modern language courses were taught.

In 1965 the HEA incorporated HEFA as Title VII of the new act and removed the restrictions on the types of facilities that could be constructed. Title VII included programs that provided grants and low-interest loans to assist higher education institutions to construct or renovate academic facilities. In subsequent years, the provisions of Title VII were expanded or modified to include loan guarantees and interest subsidy grants, which reduced the interest rate on privately funded facilities loans. When ED was created in 1980, the college housing program was transferred to it and included in Title VII of HEA.

In 1986, the College Construction Loan Insurance Corporation (Connie Lee), a for-profit, government-sponsored enterprise, was created. Its purpose was to help creditworthy institutions with low bond ratings issue bonds to finance the construction of facilities by offering bond insurance that would result in lower interest rates on the bonds. Subsequently, Connie Lee was privatized and entered into bankruptcy. It no longer exists.

At its height in the 1950s and 1960s, the college housing program supported the building of more than a half-million dormitory units. Title VII of the HEA supported billions of dollars of facilities construction. Through the 1960s, Title VII provided as much or more funding for higher education than the Title IV student aid programs. In the debate over the passage of the HEA in 1965, many members of Congress saw support for building facilities and provision of student aid as a two-part strategy to expand educational opportunity.

In 1998, Title VII, including the college housing program, was repealed. There is no general legislative authority in the HEA for construction assistance. Loans have not been approved for subsidization under the subsidy grant program since FY 1973, and new loans have not been made under the College Facilities Loan Program since FY 1986. Small and declining appropriations are still being made to meet prior subsidy obligations.

Funds available under Title III of the HEA, Institutional Aid, for financially struggling institutions serving low-income students, Tribal Colleges and Universities and Historically Black Colleges and Universities can be used for construction as well as myriad other purposes. Recent amendments brought the Historically Black College and University Capital Financing Program, which provides federal insurance for bonds for construction, repair, and renovation, into Title III (from Title VII). In addition, the program to support Hispanic-Serving Institutions, now located in Title V, permits funds to be used for construction as one of fourteen authorized activities.

What are the options for changing and improving policy through the HEA? A broad program of direct federal support for the construction of academic facilities could be reinstituted in the form of grants, direct loans, loan guarantees, interest rate subsidies, or bond insurance. Support could be targeted at particular types of facilities (e.g., science laboratories) or at "needy" institutions. Some level of institutional or state matching could be required. Funds could be distributed by formula among the states or institutions or awarded on a competitive individual project basis.

What are the trade-offs involved in choosing among options? Except for the very limited amount of funds available to select and small categories of institutions through Titles III and V, general federal support for higher education facilities basically ended in the 1970s. The responsibility for meeting the infrastructure needs in higher education has shifted to local and state governments and private institutions. The federal government no longer plays a significant role as a partner or contributor. This is only occasionally mitigated by federal appropriations earmarking funds for the construction of a facility at a specifically named institution that was able to obtain congressional favor. These earmarked construction projects total a very small amount annually.

The key questions are as follows: Should the federal government resume any or all of those programs that were part of the pre-1998 Title VII, or should institutions of higher education continue to rely completely on state and local government and private sources? Does the federal government have a role in building the academic facilities to accommodate the approaching wave of new enrollments in higher education? Is there a national interest in providing adequate higher education facilities, or is this entirely a state, local, and private responsibility?

Financial Assistance for Distance Education Students

Making academic programs available through distance education can, at least in theory, help alleviate shortages of academic facilities. Students can study at home or at their workplace, thus putting less of a demand on campus classrooms. For this to be a viable strategy, students enrolling in distance education programs must be eligible for Title IV funds. However, some provisions in Title IV have been identified as barriers for students desiring to participate in distance education. The principal barrier is the "50 percent rule," which appears in Section 102(a)(3) of Title I. It provides that institutions that enroll more than half of their students in distance education, or that offer more than half of their courses through distance education, cannot enroll students receiving Title IV assistance. Some institutions, particularly so-called virtual universities, want to offer most or all of their instruction through distance education.

Until the fall of 2002, another alleged barrier was the "12-hour rule," found in regulations (34 CFR Part 668). It required that to be eligible to participate in federal student aid programs, educational programs that do not operate under a traditional calendar – semester, trimester, or quarter system – must provide at least 12 hours of in-class instruction each week. Technological advances and increased adult student demand have resulted in a proliferation of nonstandard academic calendars in recent years. Institutions are offering programs in shorter time periods, for example six or eight weeks; in overlapping terms with multiple start dates; or in other nontraditional formats. For these programs, the distinction between instruction time and "home work," which was implicit in the 12-hour rule, no longer was relevant. Denying students in such programs Title IV aid threatened to preclude their access to these educational options.

For these reasons, ED eliminated the 12-hour rule. It now treats academic programs using nonstandard calendars in the same way that it treats programs that use the standard academic calendars of semesters, trimesters, or quarters. In both cases, an instructional "week" is any week in which one day of regularly scheduled instruction, examination, or examination preparation occurs, regardless of whether that activity occurs face-to-face with a faculty member or at a distance. What exactly has to occur during this one day for it to justify the designation of "one week" of an academic program remains ambiguous. There is no clear benchmark for how much time on task, i.e., time spent actually learning, a student must spend in order to be considered a full-time student. This area may require further oversight during the HEA reauthorization.

What are the options for changing and improving policy through the HEA? An important option is to amend the HEA to eliminate the 50 percent rule. On October 10, 2001, the U.S. House of Representatives overwhelmingly passed H.R. 1992, the Internet Equity and Education Act of 2001, which would, for some institutions, eliminate the 50 percent rule. An institution would be exempt from the rule if its loan default rate has been below 10 percent during the previous three years. No further action was taken on the bill in the 107th Congress.

While many distance educators praised the bill, some faculty groups and others criticized it, saying that the current law ensures some measure of academic quality by requiring a substantial component of traditional face-to-face instruction at every institution that is eligible to participate in the Title IV programs. They argue that if the rule is rescinded, students could be defrauded by illegitimate operations that provide inferior and perfunctory instruction designed largely to take advantage of federal financial aid. Proponents of the change counter by stating that neither the place where instruction occurs (a college campus versus at home) nor the form of the instruction (traditional classrooms versus distance education) is a guarantee of the quality of the learning that takes place.

Another option to reduce barriers to receipt of financial aid by distance education students is to administer such aid on a student-by-student basis for students enrolled in nonstandard academic calendars. The Community Colleges of Colorado are testing a new model that decouples the delivery of student aid for costs related to instruction – such as tuition, fees, books, and supplies – from costs related to living expenses. Students receive aid for instructional costs as they complete various milestones in their educational programs, and receive aid for living costs on the basis of the number of months in which they were actually enrolled. In short, the aid awarded for instructional costs is disbursed on the basis of student progress; aid for living expenses is awarded on the basis of months elapsed. An obvious issue is whether students could progress academically at a very slow rate, drawing on small amounts of aid for instructional costs while drawing aid for living expenses more quickly and in much larger amounts.

As part of an experiment on ways to deliver financial aid in a competency-based educational environment, Western Governors University (WGU) is measuring a student's progress not on the number of courses taken but rather on the progress he or she is making toward fulfilling competencies required for a degree or certificate. The model is driven by an individualized student academic action plan. WGU currently provides aid for direct instructional costs but not for living expenses.

More generally, for students receiving instruction through distance education, financial aid could be allocated more frequently than it is to traditional students and in smaller amounts related to their academic progress. This progress could be continuously measured by time spent on learning tasks or by the attainment of achievement or learning benchmarks. Current practice is to provide students with all of the aid for a standard academic calendar period, such as a quarter or a semester, in a single allocation. This practice is clearly inappropriate for students who are progressing at a self-paced rate.

The appropriate relationship between federal student aid and distance education and maintaining program integrity and academic quality in distance education programs is being addressed by the Distance Education Demonstration Program. This program was created by the Higher Education Amendments of 1998 (section 486). Its purpose is "to help determine (A) the most effective means of delivering quality education via distance education...; (B) the specific statutory and regulatory requirements which should be altered to provide greater access to high-quality distance education programs; and (C) the appropriate level of Federal assistance for students enrolled in distance education programs." The program authorizes ED to waive provisions of law and regulation that "inhibit the operation of quality distance education programs," evaluate the effects of these waivers on facilitating quality distance education programs, and make reports to the Congress, including "any proposed statutory changes designed to enhance the use of distance education."

Taking into account all the institutions in systems and consortia that have been selected for the program, well over 100 institutions are included in the program. All of these institutions benefited from waivers of the 50 percent rule as well as from various rules defining academic time periods (e.g., the 12-hour rule). ED's first report on the program, issued in January 2001, contains extensive discussion but offers no specific findings or recommendations. A second report that concerns the 12-hour rule, issued in July 2001 and developed at the explicit request of the House Appropriations Committee, also makes no specific findings or recommendations. Thus far, ED seems to have used the program as a discretionary benefit for selected institutions rather than as a means to gather information for improving policy.

The 1998 HEA reauthorization also established a Web-Based Education Commission. The original purpose of the Commission was to assess the educational software available in retail markets for postsecondary students; however, the Commission broadened its scope to include ensuring "that all learners have full and equal access to the capabilities of the World Wide Web." In December 2000, the Commission issued its report, *The Power of the Internet for Learning: Moving from Promise to Practice.* The report addresses several policy issues, including technology trends, content and teaching strategies for the Internet, access and equity, technology costs, and regulatory barriers. Among its seven general recommendations, the Commission called on all levels of government "to remove barriers that block full access to online learning resources, courses, and programs while ensuring accountability for taxpayer dollars." Unfortunately, it did not provide any specific guidance on reconciling these competing goals.

What are the trade-offs involved in choosing among options? The key issue with regard to changing the financial aid provisions is how to make changes that allow the continued development of innovative educational programs, particularly distance education, while ensuring educational quality and avoiding the potential for fraud and abuse. It is also important that any changes be broadly understandable to the public and higher education professionals, that they be workable for all the various ways that higher education is currently provided, and that they be flexible enough to fit circumstances that have not currently been envisioned. H.R. 1992 would eliminate the 50 percent rule only for

institutions that are currently providing financial aid and have a default rate that has been below 10 percent for the previous three years, thereby providing assurance that only established and well-managed institutions (at least with regard to defaults) would be included. New and innovative institutions, on whose behalf the change is presumably being made, would be excluded.

In a 1998 report, cited in the Selected Resources, the Institute for Higher Education Policy reported six general principles for financial aid policies for students in distance education programs. These may be a useful point of reference in thinking about modifications to Title IV to accommodate students in quality distance education programs.

Accreditation

Accreditation is a means of self-regulation and peer review adopted by the higher education community to examine colleges, universities, and educational programs for quality assurance and quality improvement. In the United States, accreditation is carried out by private nonprofit organizations designed for this specific purpose. The accrediting process is intended to strengthen and sustain the quality and integrity of higher education, making it worthy of public confidence and minimizing the scope of external control.

Accreditation is an expression of confidence in an institution's mission and goals, performance, and resources. On the basis of the results of a self-study and an evaluation by a team of peers, accreditation attests to the judgment of the accrediting agency that an institution has met several criteria, including 1) that it is guided by well-defined and appropriate goals, 2) that it has established conditions and procedures under which its goals can be realized, 3) that it is accomplishing its goals substantially, 4) that it is organized, staffed, and supported so that it can be expected to continue to accomplish its goals, and 5) that it meets the standards of the accrediting commission.

Regional accreditors operate in eight clusters of states (regions) in the United States and review entire institutions, 98 percent of which are both degree-granting and nonprofit. There are more than 2,900 regionally accredited institutions. National accreditors operate throughout the country and also review entire institutions, 34.8 percent of which are degree-granting and 65.1 percent of which are non-degree-granting, and of which 20.5 percent are nonprofit and 79.5 percent are for-profit. Thus, the regional accreditors primarily deal with degree-granting nonprofit institutions, and the national accreditors primarily deal with non-degree-granting for-profit institutions. There are 3,419 nationally accredited institutions.

Although federal reliance on accreditation dates from the late nineteenth century, the role of accreditation was most profoundly affected by the post-World War II G.I. Bill. Under this program of postsecondary education benefits to veterans, the federal government first attempted to ensure that students received a minimum level of quality in their education when it was paid for with federal funds. Quality was to be ensured without the establishment of federal standards for academic quality or direct federal oversight of institutions. Instead, the federal government would rely on accreditation to certify quality.

The Program Integrity provisions of Title IV (Part H) outline specific responsibilities for accrediting bodies, the states, and ED, with respect to assuring quality in postsecondary education. Congress, in an effort to reduce fraud and enhance quality, amended the HEA in 1992 to strengthen ED's control over accreditors by imposing more rigorous recognition procedures and by specifying the standards it expected the accreditors to monitor. As a result, the subject areas that are expected to be measured and monitored by accrediting agencies are now written into federal law. They include, among others, curricula, faculty, program length, and student support services.

Technology-mediated distance education has profoundly altered the teaching-learning process and poses a major challenge to the accreditation process. Pedagogical techniques, the relationship of students to their teachers and their institutions, the uses of resources to achieve educational outcomes, the measures of learning, and academic calendars are all changing rapidly. In some cases, educational technology and distance education are used as supplements to traditional classroom instruction; in other cases, virtual universities offer entire programs that are dramatically different from traditional higher education. Defining "quality" in this new context and devising measures and benchmarks are very difficult. The HEA currently does not offer any guidance or provide any standards related to distance education and the recognition of accrediting agencies.

The eight regional accrediting organizations have acted on their own and adopted a common platform for review of distance learning. The nine national accreditors also have independently developed standards, policies, and processes for the evaluation of distance learning. The standards used by both regional and national accreditors focus on the following seven features of institutional operation: 1) institutional mission, 2) institutional organizational structure, 3) institutional resources, 4) curriculum and instruction, 5) faculty support, 6) student support, and 7) student learning outcomes.

Within each of these categories, special attention is directed to distance learning programs. The following are a few examples of these standards taken from *Accreditation and Assuring Quality in Distance Education*, published by the Council for Higher Education Accreditation (CHEA) in 2002.

- **Mission.** Distance learning programs must be consistent with the institution's mission and limited to those subject areas for which the institution has expertise.
- **Institutional Organizational Structure.** All distance learning must be approved and administered under established institutional policies and procedures, and supervised by an administrator who is part of the organizational structure.
- **Institutional Resources.** Distance learning programs must not adversely affect the institution's administrative effectiveness, result in faculty overload, or cause financial stress or instability.
- **Curriculum and Instruction.** All programs must be consistent with those offered on campus.

What are the options for changing and improving policy through the HEA? The Program

Integrity section of HEA could be modified to provide specific guidance to accreditors in their review of institutions that offer some or all of their programs through distance education. For example, accrediting agencies could be required to place a priority on monitoring distance education programs. In addition, accrediting agencies could be required to target their oversight on those online courses that are not based on courses already being offered in the traditional classroom format. Finally, additional emphasis could be placed on student outcomes. Although discussions of student outcomes in higher education have raged for decades, there is still little agreement on how to measure them – or whether they can be measured at all. There is also a debate over the relationship between time spent in an educational program and learning outcomes. Nevertheless, it would seem elementary that learning can occur only if time is spent on the task. Then one can measure either the time on task, assuming that it leads to learning, or the outcome value added – i.e., how much more does the student know or how much more is the student able to do.

Because of the critical impact that distance learning is having on the teaching/learning process, the federal government could choose to provide its own regulators for certain areas. The federal government now has authority – if it chooses to use it – to be more prescriptive and to set standards for faculty, curriculum, and student achievement in relation to mission. This, of course, would be a significant departure from what historically has been a private, peer-review activity. It would also create regulatory burdens on institutions of higher education and perhaps undermine the ability of accrediting agencies to play their traditional role in assuring quality.

Current and continuing international trade negotiations pose another threat to the traditional role of the accreditation process. In these discussions, higher education is treated as a service industry that sells its products in international trade. One possibility is that in return for giving access to foreign markets for U.S. higher education services, the United States would open its market to foreign higher education providers. These foreign providers would not necessarily be subject to all U.S. quality assurance requirements, including accreditation. Thus, higher education could be offered in the United States, perhaps with access to HEA student aid programs, without the traditional quality assurance.

What are the trade-offs involved in choosing among options? The fundamental challenge is to maintain an appropriate balance – through accreditation – between government regulation and self-regulation of higher education. At one end of the spectrum, the federal government could use its own regulators to assess the quality of distance education. At the other end, the federal government could allow accreditors to set their own standards and rely on their judgment. Nevertheless, given the complicated issues surrounding distance learning, does the accrediting community possess the necessary will and expertise to guard against fraud and abuse while ensuring quality and accountability? In other words, is the process that accrediting agencies use to evaluate the quality of institutions – self-study by the institution against the agency's standards followed by peer evaluation and final action by a commission or council – sufficient to address the challenges that distance education poses? Or does the federal government need to prescribe standards to provide guidance for accreditors or undertake a more direct regulatory role? Perhaps these issues merit thorough

examination through a study mandated in the reauthorization. The study could be undertaken by ED, GAO, or the National Academies of Science. Another possibility would be to create an independent commission to do the study.

Institutional Digital Divide

Educational technology to meet future enrollment demands as well as to improve educational quality generally is expensive. There is a gap between institutions that have access to the latest educational technologies and those that do not. In general, large, well-financed institutions have greater access to information technology funding than do smaller colleges with fewer resources. ED studies draw attention to the fact that in 1997–98 larger institutions were more likely to offer distance education than smaller colleges: 87 percent of institutions with more than 10,000 students, in contrast to only 19 percent of institutions with fewer than 3,000 students, offered distance-based classes. More recent information shows that three out of four public institutions provide distance learning opportunities, compared with about one in five private institutions. Also, the larger an institution's enrollment, the more likely it will be to offer distance education classes. In short, the probability that a small private institution will offer distance education is much less than the probability that a large public institution will do so. Some small private colleges, such as Oberlin College or Williams College, have ample resources to incorporate educational technology into their educational program. These and other institutions may also choose not to engage in distance education for programmatic reasons rather than because of their lack of resources. Nevertheless, the institutional digital divide potentially compromises the quality of the educational programs and opportunities available to some students and the ability of some institutions to meet enrollment demand.

In its report to the President's Information Technology Advisory Committee, Educause, an education technology consortium, asserted that the federal information technology investment in higher education has resulted in a network capability at the largest universities that far outpaces that of other four-year degree-granting institutions. The report notes that smaller institutions, including many Historically Black Colleges and Universities, Hispanic-Serving Institutions, and Tribal Colleges, face severe challenges in meeting the advanced networking requirements necessary to educate today's students. The report identifies the following technological obstacles:

- Lack of campus infrastructure;
- Lack of reliable middleware (security, authentication, and network management tools); and
- Lack of cooperation from telecommunication companies in providing service.

Significant nontechnological obstacles to advanced network deployment include:

- A difficult economic environment for information technology and networking at smaller institutions because advanced networking is often a new budgetary item;

- Lack of high level support from campus decision makers;
- A return-on-investment that is difficult to articulate; and
- Difficulty recruiting and retaining information technology staff.

Some of the differences among institutions' approaches to distance learning are the result of institutional choice rather than a lack of funding. Nevertheless, analysis reveals disparities between research universities and teaching institutions that appear to reflect resource differences more than institutional choices. Large public and private research universities have the best ratios of information technology staff to FTE students; are more likely to offer admissions, financial aid, course registration and library resources over the Internet; and to have off-campus dial-up Internet services for students and faculty than small private institutions are.

What are the options for changing and improving policy through the HEA? Titles III and V of the HEA contain general language authorizing minority-serving institutions, as well as financially struggling institutions serving large numbers of low-income students, to spend program funds for improving technological capacity and using technology in instruction and administration. These provisions could be expanded to meet the educational technology needs of this subset of institutions of higher education. For example, S. 414, the NTIA Digital Network Technology Program Act, was introduced in February 2001 and reported from committee in July 2002. It would authorize funds for this group of institutions to acquire technology infrastructure and to train educators in the effective use of technology. This bill could serve as a model for expanding the existing HEA provisions.

In the 1998 reauthorization, the Learning Anytime, Anywhere Partnerships (LAAP) program was created. Its purpose was "to enhance the delivery, quality, and accountability of postsecondary education and career-oriented learning through technology and related innovations" (Subpart 8 of Part A of Title IV). Funds available under the program were used to develop model distance education programs, and innovative educational software, to develop measures of skill competencies of students in distance education courses, and to develop innovative student support services for a distance education environment. The program received appropriations of $10 million in FY 1999, $23.3 million in FY 2000, and $30 million in FY 2001. No appropriation was provided in FY 2002. Perhaps the experience with this program could serve as a platform upon which to build legislation to address the programmatic aspects of the digital divide.

A de facto program exists to provide funding for educational technology at colleges and universities in the form of earmarked funds in appropriations bills. In the FY 2002 appropriations bills, $1.84 billion was earmarked for projects at institutions of higher education. A substantial portion of this money was for "technology infrastructure," "distance education," "technology enhancements," "information technology," "computers," and similar purposes. One option for the reauthorization would be to establish a program making funds available to colleges and universities for technology on a competitive basis. Priority in the distribution of funds could be given to overcoming the institutional digital divide.

A major problem with technology financing is the lack of standard terminology for describing the elements of technology infrastructure. This lack of a common vernacular can make it difficult to know for what should funds be authorized. Also, although infrastructure traditionally connotes bricks, mortar, and equipment, it has become clear that technology infrastructure must include skilled people and ongoing training as the highest priorities for building and sustaining technological capacity. The Institute for Higher Education Policy has developed a definition of technology infrastructure that includes three broad clusters: building infrastructure, systems infrastructure, and personnel infrastructure. Building infrastructure includes the computer cables, electrical wiring, and electrical power necessary for the effective use of communication technology. Systems infrastructure is made up of three elements: data systems (computer networks with appropriate software), voice systems (two-way telephone systems), and video and multimedia systems (all forms of video transmission within and outside the institution). Personnel infrastructure encompasses the human resources included for network management, training and technical assistance, course content development, administrative support, and student support services related to technology-aided instruction. This new lexicon could be incorporated into any legislation addressing the institutional digital divide to more effectively target funds to areas of particular need.

Disabled Students

The number of students with disabilities enrolled in colleges and universities and their proportion of total enrollments have increased significantly. According to surveys, the share of college freshmen who self-reported that they have a disability increased from just under 3 percent in 1978 to more than 9 percent in 1998. A 1999 study sponsored by ED found that about 6 percent of all undergraduates reported having a disability in 1995–96. About 45 percent of disabled students attend public two-year institutions, 42 percent go to public and private four-year institutions, and the remaining 13 percent attend other kinds of less-than-four-year institutions.

Young people with disabilities are less likely to go on to higher education and persist in their education than nondisabled students are. Two years after completing high school, about 63 percent of high school graduates with disabilities enroll in a postsecondary institution, compared with around 72 percent of graduates without disabilities. According to a Harris Poll, 12 percent of people with disabilities, compared to 23 percent of nondisabled adults, report having graduated from college.

Requirements for physical accessibility of facilities in postsecondary education for people with disabilities are dealt with by laws and regulations outside of the HEA. However, the costs of meeting these requirements could be provided by facilities programs under the HEA. Part D of Title VII deals with important aspects of the issue of program accessibility for students with disabilities, providing these students with full access to the academic, social, and cultural offerings of institutions of higher education. The Demonstration Projects to Ensure Students with Disabilities Receive a Quality Higher Education was authorized in 1998 and received $5 million in FY 1999 and FY 2000, $6 million in FY 2001, and $7

million in FY 2002. The program primarily funds the development of model strategies for teaching students with disabilities and professional development and training for faculty and administrators to enable them to more effectively meet the postsecondary educational needs of students with disabilities. Among the TRIO programs, Student Support Services, which serves undergraduate students, is designed to provide services to students with disabilities to help them succeed academically.

What are the options for changing and improving policy through the HEA? The fundamental issue with respect to students with disabilities is to enhance their ability to receive instruction that is of equal quality and effectiveness as that of students without disabilities. Moreover, disabled students should have complete access to programs in which they desire to enroll. These requirements demand that attention be paid to at least three areas: 1) eliminating physical barriers to appropriate academic facilities, 2) developing curriculum that recognizes the needs of disabled students, and 3) training teachers to work effectively with disabled students.

Part D seeks to address some of these areas, however important questions remain. Have the demonstration projects identified viable and meaningful program models that will insure that disabled students receive quality instruction? Have results of successful demonstration projects been disseminated? Is there a federal role for continued demonstration and development or for the development of more aggressive and systematic programs? Does Student Support Services adequately address the needs of the students with disabilities who are served by it?

Another area that may need attention and that is not included in Part D is the transition from high school to college. Given that fewer students with disabilities attend a postsecondary institution two years after graduation from high school than other students, more extensive efforts may be needed to improve articulation from high school to college for disabled students. Some strategies could include assistance with planning academic courses or vocational training, career counseling, mentoring, and coaching.

Selected Resources

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"Why do college prices go up so much?"

Accountability for college prices

Background

The price of higher education for students and families – reflected in tuition charges – has been increasing rapidly over the last two decades in relation to family income levels. The result is declining affordability for many groups of students. Many policymakers have asked what factors have been driving these price increases and whether they are justified. In an October 2002 hearing of the House Committee on Education and the Workforce, Chairman John Boehner noted that "many of us hear from parents and students about their worries over funding a postsecondary education. It concerns me that at a time when we make available far in excess of $50 billion a year in federal student financial assistance . . . parents and students are afraid they won't be able to pay for college!"

There are several dimensions to the federal government's interest in price and cost issues. Concern exists about students' ability to pay for college – which may mean low-income students' access to any form of postsecondary education or middle-income families facing college prices beyond what they can or are willing to pay. A related concern is how students are meeting rising college prices, particularly their increasing reliance on borrowing. Policymakers are also worried about the escalating costs of the federal student aid programs as they seek to keep pace with college prices and wonder whether the student aid programs contribute to increases in college prices.

Despite these diverse and intense interests, the HEA has addressed the issue of college prices on only a limited basis. If policymakers decide to deal with college prices and costs more directly and aggressively in the HEA reauthorization, two questions become crucial to the debate. First, is it appropriate for the federal government to play a role in college pricing decisions? Second, how would such a role be defined, and do any policy tools or interventions exist through which the federal government could successfully affect price levels in higher education?

In any discussion of college costs and prices, it is important to be clear about terminology. The terms most relevant for this discussion are 1) *price* – the amount students are charged and what they pay for educational services; 2) *sticker price* – the tuition and fees that institutions charge (the published price); 3) *total price of attendance* – the tuition and fees ("sticker price") that institutions charge, plus other expenses related to their education such as room, board, books, and transportation (often referred to as the "cost of attendance"); 4) *net price* – the amount students pay after financial aid is subtracted from the total price of attendance (often referred to as "out-of-pocket costs"); and 5) *cost* – the amount institutions

spend to provide education and related educational services to students (usually measured through expenditures, such as instruction or administrative expenses). In addition, it is essential to keep in mind the concept of subsidy. At most public and private not-for-profit colleges and universities, the overwhelming majority of students are subsidized to some extent using money from non-tuition sources, such as state government appropriations and endowment income. This means that for almost all students, the price they pay to attend a college or university does not cover the cost to the institution of educating them. The difference between educational costs and the price is the subsidy.

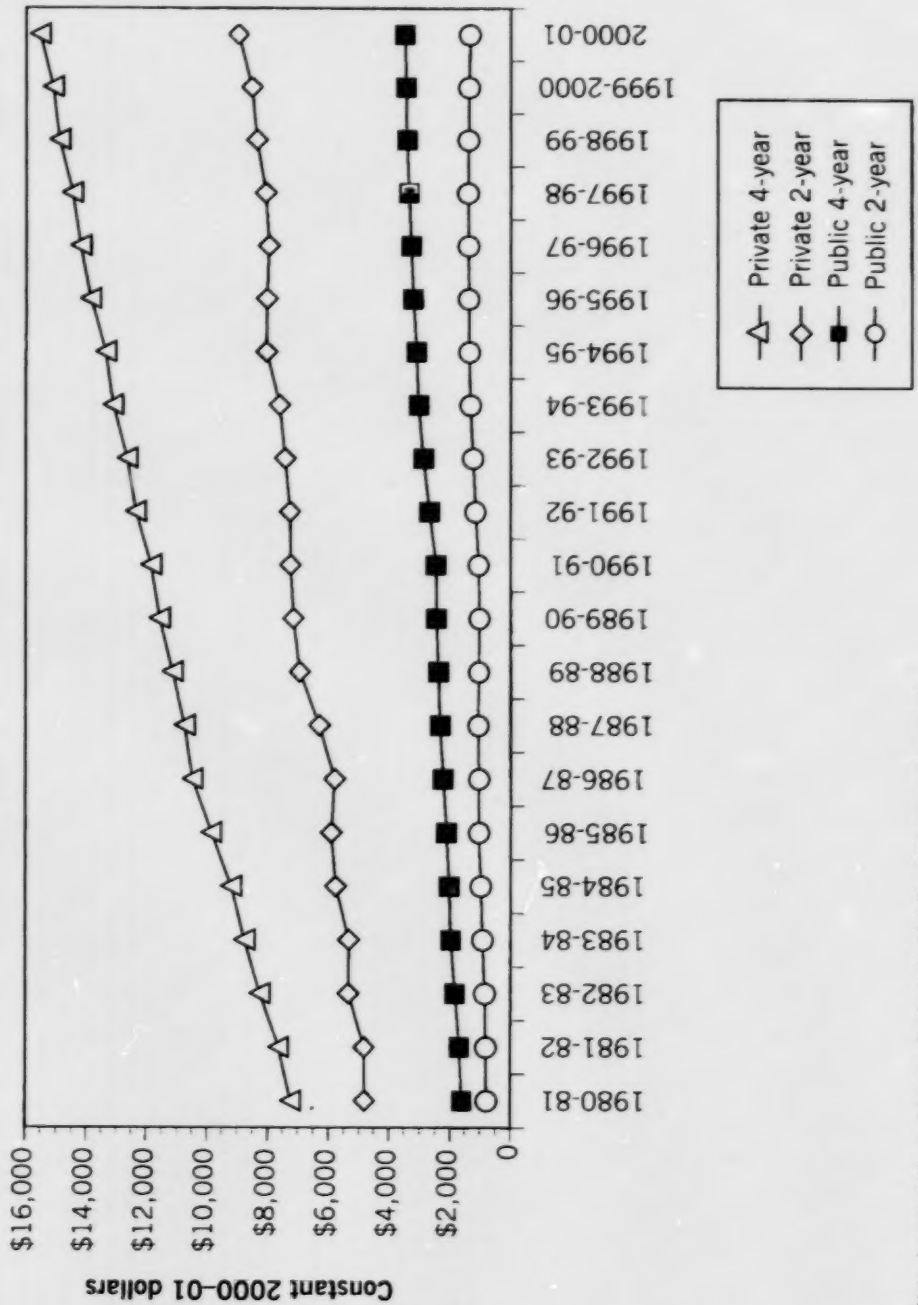
Average tuition and fees (sticker prices) vary considerably according to the type of college or university. Most published data focus on tuition and fees for full-time, full-year, undergraduate students, for in-state residents in the case of public institutions. In 2000–01, average in-state tuition and fees were $1,359 at public two-year institutions, which enroll about 42 percent of undergraduates; $3,506 at public four-year institutions, which enroll an additional 38 percent of undergraduates; $15,531 at private four-year institutions (18 percent); and $8,961 at private two-year institutions (2 percent).

Over the last two decades, sticker prices have increased faster than inflation for all types of institutions, with the rates of increase sharpest for private four-year colleges in the early and mid-1980s and for public institutions in the early 1990s. (Because room and board costs generally have increased at a much lower rate than have tuition and fees, percentage increases in the total price of attendance were slightly lower.) After slowing somewhat in the late 1990s, tuition prices appear to be increasing sharply again, especially in the public sector as states are faced with declining revenues and budget shortfalls (see Figure 1). Tuition prices, moreover, have increased faster than most types of college costs (expenditures made to educate students by colleges and universities). For example, in the 1990s, tuition increased at a faster rate, on average, than did expenditures for instruction (the bulk of which are spent on faculty salaries), academic support, student services, and institutional support, at most types of institutions.

The majority of undergraduates still attend institutions with relatively low levels of tuition – in 1999–2000, more than three-quarters of all undergraduates attended colleges with average tuition levels of less than $4,000. However, the increases may be presenting problems for families with low and moderate incomes. Over the last two decades, tuition levels generally increased faster than average family incomes, especially incomes at the lower end of the scale, meaning that low-income families must use increasing shares of their income to pay college expenses (see Figure 2).

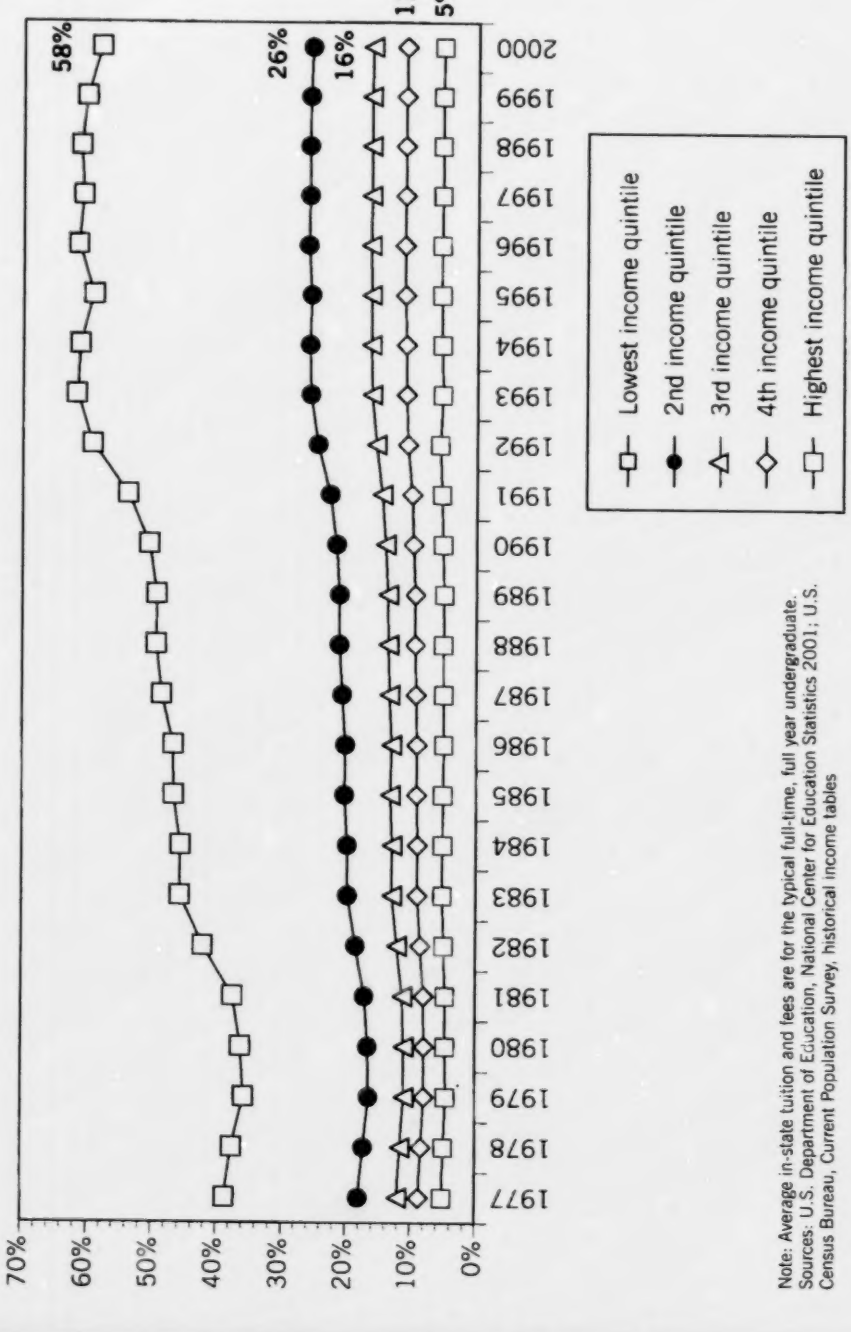
Many students, families, and policymakers focus on published tuition levels (sticker prices), leading to "sticker shock." Yet it is important to keep in mind that increases in sticker prices can be offset with financial aid, thereby reducing the out-of-pocket costs (net prices) to the student. Net prices can be defined in different ways, depending on whether tuition or total price (including room and board) is used and what type of financial aid is subtracted. Although increases in financial aid have not kept up with rising tuition, they generally have enabled net prices to increase at a slower rate than sticker prices in the

Figure 1: In-state Undergraduate Tuition and Fees Adjusted for Inflation, by Institutional Type



Note: Average tuition and fees are for the typical full-time, full year undergraduate.
Source: U.S. Department of Education, National Center for Education Statistics 2001.

Figure 2: Average Undergraduate Price of Attendance at a Public Four-Year Institution as a Percentage of Family Income, by Income Quintile



Note: Average in-state tuition and fees are for the typical full-time, full year undergraduate.
Sources: U.S. Department of Education, National Center for Education Statistics 2001; U.S. Census Bureau, Current Population Survey, historical income tables

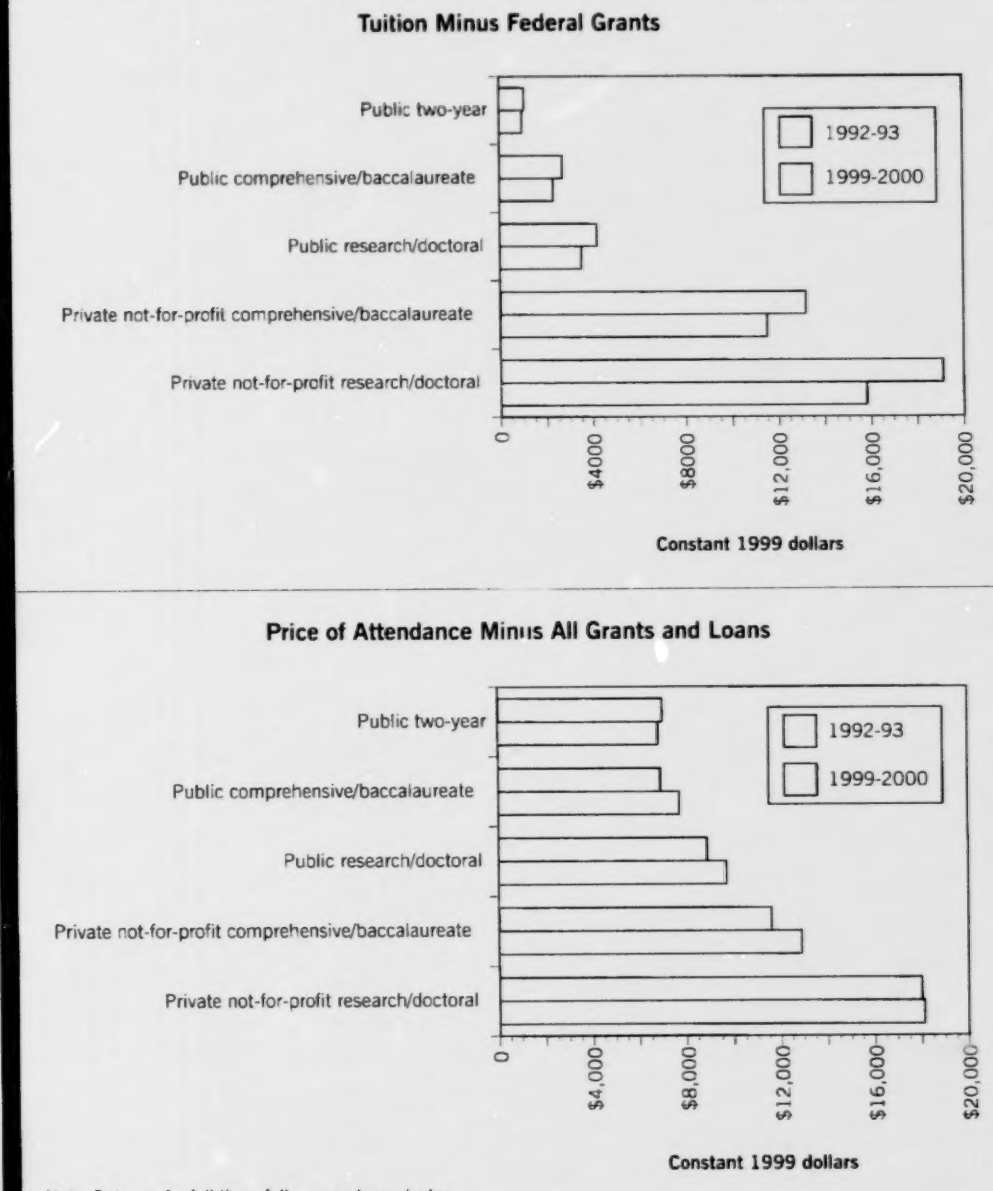
1990s. Looking specifically at tuition minus federal grants, net prices increased at most types of colleges between 1992–93 and 1999–2000. However, net prices, defined as total price of attendance minus all aid (including institutional aid and federal student loans), remained relatively stable or declined. The differences reflect the fact that funding for Pell Grants and other federal grants failed to keep pace with tuition during this period, while federal student loans – as well as institutionally provided aid – played an important role in helping many students pay for tuition and other expenses. In other words, increases in student aid from all sources were enough to keep net prices stable, but student borrowing was an important reason, especially for middle- and upper-income students (see Figure 3).

A related issue is that public and media perceptions of college prices often differ from the reality. As mentioned above, the tuition paid by most students is not as high as might be expected, judging solely on the basis of the sticker prices of most colleges. However, the media tend to focus not only on sticker prices (as opposed to net prices) but also on sticker prices at the most expensive, selective private institutions, even though many of these institutions offer substantial amounts of need-based aid to offset those prices. In addition, only a small fraction of undergraduates attend these colleges. Generally, students and their families overestimate the price of attendance and underestimate the amount of financial aid that is available to them from various sources. For example, a survey in the late 1990s found that respondents estimated tuition at public four-year colleges to be almost $10,000, which is more than 200 percent higher than the actual average tuition level.

When confronted with rising prices, the public also tends to take into account only the part of total educational costs that they pay in the form of tuition. Students and families may not recognize that the price they pay – even if they paid the full sticker price – covers only a portion of the costs of educating them. In fact, almost all students receive a subsidy as a result of the revenue most colleges receive from sources other than tuition (see below). On the other hand, the calculation of the true cost to the student should include measures of forgone income in addition to tuition, fees, and other expenses. "Forgone income" is the amount the student would have earned if he or she had been working instead of attending college. The effects of including forgone income vary, but may be considerable for some students, especially nontraditional students, who tend to have regular full-time jobs. It is also clear that the share of educational costs being borne by students and families, as opposed to taxpayers or philanthropy, has increased over time.

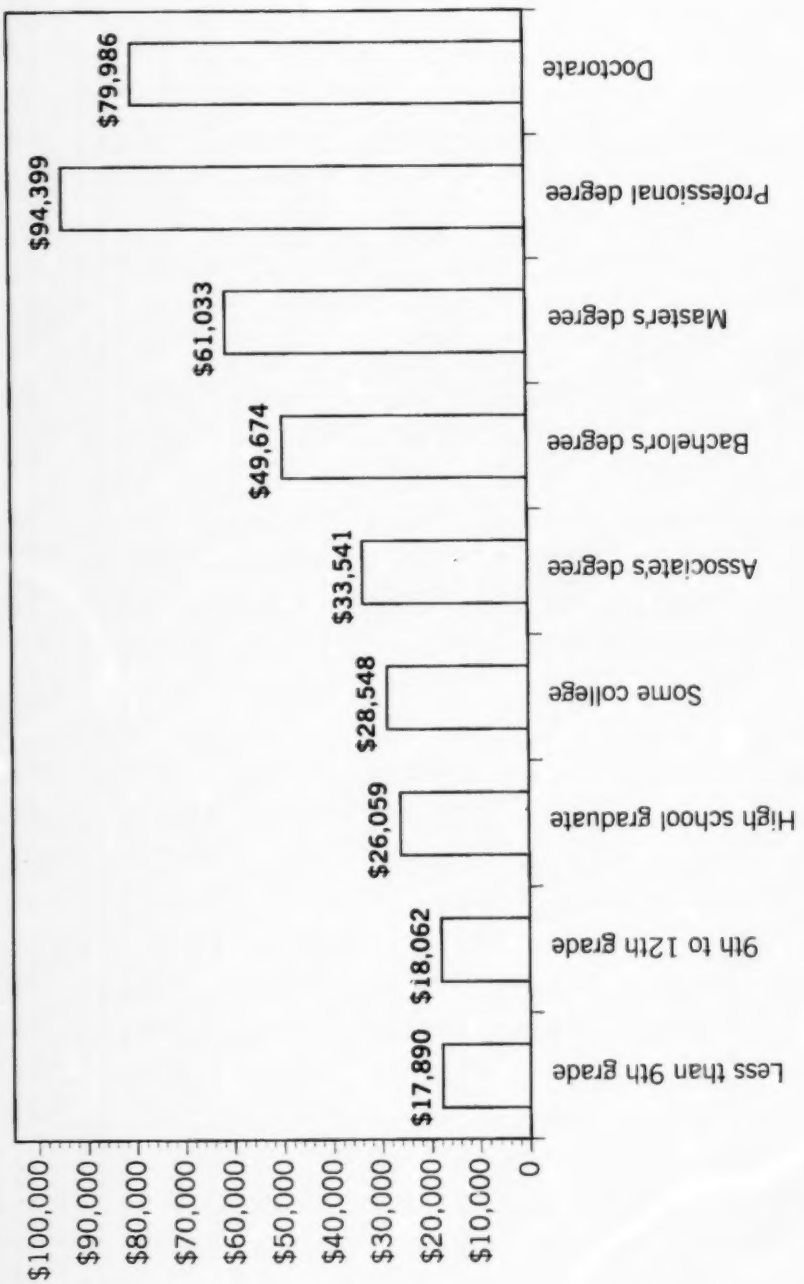
Finally, it is important to view increases in tuition prices relative to the value of postsecondary education. On average, bachelor's degree recipients earn substantially more than individuals with only a high school diploma – for example, according to Census data the average high school graduate earned $26,059 in 2000 while the average bachelor's degree recipient earned $49,674 (see Figure 4). Over a working lifetime, this earnings gap can add up to more than $1 million. Thus, the cost of not going to college also is high. The wage premium for bachelor's degree earners has been increasing over time. In fact, some evidence suggests that during the 1990s, the value of a bachelor's degree in terms of increased earnings kept pace with – and sometimes exceeded – the increases in college prices. From this perspective, tuition increases may be justified since they have produced an increasingly large pay-off.

Figure 3: Net Prices by Institutional Type, 1992–93 and 1999–2000



Note: Data are for full-time, full-year undergraduates.
Source: U.S. Department of Education. National Center for Education Statistics. 2002. *What Students Pay for College: Changes in Net Price of College Attendance Between 1992–93 and 1999–2000*. NCES 2002–174. Washington, DC: Government Printing Office.

Figure 4: Average Earnings of People 18 Years and Older by Educational Attainment, 2000



Source: U.S. Census Bureau, Current Population Survey, income tables

Causes of Tuition Increases

The preceding discussion suggests that data about college price increases are more complicated than they may seem. Another important part of the context is an understanding of the causes of price increases and their relationship to college costs and federal financial aid programs.

In thinking about the causes of increases in college prices, it is helpful to keep in mind several aspects of the higher education sector. Perhaps most important, the overwhelming majority of students are subsidized – that is, the amount they pay is less than the cost to the institution of educating them. This is because the availability of non-tuition revenue (such as state appropriations and endowments) allows colleges to charge tuition that is lower than the cost of education. This is particularly true for public institutions – on average, public institutions in 1996–97 derived 81 percent of their current fund revenue from non-tuition sources (including 36 percent from state government funds). However, private not-for-profit institutions also derived 72 percent of their current fund revenue from non-tuition sources in that same year. Conversely, tuition tends to be the primary revenue source at for-profit institutions, which act more like private firms and by definition charge a price that is higher than the cost of education in order to make a profit.

It is also helpful to note that the postsecondary education sector – including more than 4,000 degree-granting institutions as well as thousands of non-degree schools – is segmented, with a wide diversity of options and multiple markets. Some of these markets can be broadly characterized as follows:

- **Public institutions**. Prices at public four- and two-year institutions are determined by state or institutional governing boards, based on state appropriations. Some institutions have authority to set their own tuitions and others do not, but for all, the final decisions are made once appropriations are set. Decisions about enrollment and student aid also are influenced by state and local policy. Given the substantial portion of revenues that tend to come from state and local appropriations, cuts in these funding sources have an impact on pricing decisions. Some flagship public universities, especially those with more institutional autonomy, may face environments similar to those of selective private institutions (see below).
- **Highly selective institutions** (primarily private not-for-profit). This is a small but very visible segment of higher education, including about 150 institutions and enrolling approximately 5 percent of undergraduates. These institutions, which tend to draw students nationally, compete strongly with each other, usually on the basis of institutional reputation and other non-price mechanisms. They face excess demand, with more students applying than there are spots for them – a ratio of up to nine to one at the most selective schools. Prices at these schools tend to be quite similar. In addition, this group tends to have higher levels of institutional wealth (usually the result of endowments) in comparison with other institutions.
- **Competitive institutions** (private not-for-profit). Within this group exist many smaller markets in which peer institutions compete intensely. Competition tends to be of a

regional nature, and competing colleges are more or less substitutes for each other. Like highly selective institutions, they often compete for students through institutional reputation and other factors. Increasingly, they also compete through charging different prices to specific groups of students, i.e., by discounting the published tuition for certain students as a means of encouraging them to enroll (this process often is referred to as "enrollment management"). Within each marketing band, tuition levels tend to be within a narrow range.

- **Proprietary institutions**. These institutions are very diverse and offer a wide range of educational programs and other services. Nonetheless, they all operate in a for-profit market, where tuition makes up most of their revenue and the costs of educating a student are most directly tied to prices (with prices exceeding cost, so as to earn a profit).

The causes of tuition increases are diverse and complicated. Overall, one can think about the causes as including a combination of internal budgetary factors on both the cost (expenditure) and revenue sides and external factors related to the market environment and student demand.

- **Internal factors** reflect institutional considerations that have an impact on the supply of postsecondary education, including decreases in revenue from state appropriations; increases in expenditures on instruction, administration, and technology; rising institutional aid budgets; and low rates of increase in productivity.
- **External factors** relate to the environment in which an institution exists. They include increasing levels of family income in the state or region, tuition levels at competing institutions, increases in the value of higher education to the student, and rising numbers of college-bound students. All of these factors have an impact on students' demand for enrollment spaces.

The combination of factors contributing to tuition increases varies, depending on the type of institution and the market in which it operates. For public institutions, the primary influences tend to be budget considerations. In the 1990s, for example, the single most important factors related to tuition increases at public four-year institutions were relative decreases in revenue from state appropriations, which on average are the largest source of revenue for these institutions. State budgets may be cut because of economic downturns or because of competition for state resources by other priorities, such as K–12 education or prisons, that do not have non-government funding sources. The resulting price increases are not necessarily the result of explicit changes in state tuition policies, but rather occur when public institutions try to maintain their total revenue. On average, institutional expenditures on instruction and other needs increased at these institutions during the 1990s, but at substantially lower rates than the price increases. Community colleges are slightly different. Despite a high degree of variability across states and districts in how tuitions are set, in general efforts are made to keep tuitions low at these institutions, and this may constrain their ability to raise tuition. As a result, many community colleges made program cuts or otherwise reduced expenditures when revenues from state or local government decreased.

Tuition decisions at private not-for-profit four-year institutions are related to a wide range of internal and external factors. These institutions, like public institutions, are concerned with internal budget considerations, including institutional expenditures on faculty compensation and other expenses; however, non-tuition revenues from private gifts and endowments are more important to them than revenue from state or local governments. Private not-for-profit institutions also are influenced by external market conditions, such as the price of attendance at competing public four-year institutions and family income levels in the areas from which they draw students. An important factor related to pricing decisions at private not-for-profit institutions is institutional financial aid to students, which functions as a "discount" in the price paid by certain students. Colleges may decide to raise their published tuition levels and simultaneously increase their institutional aid funds; at many colleges, well over 50 percent of students then receive a discount on the published price. Many colleges, especially selective institutions, use tuition discounting to compete for students in their particular market. They also use institutional aid to encourage needy students to attend, because many of these colleges aim for a diverse student body. In some markets, then, competition may cause sticker prices to increase rather than decrease, although the ultimate effects of increasing both sticker prices and institutional aid on net tuition revenues to the institution vary, depending on the institution's enrollment capacity and financial aid policy.

Less research has been conducted on the tuition-setting process at for-profit (proprietary) institutions. However, decisions about tuition at these institutions are clearly tied more closely to the cost of educating students and to the nature of market demand, as these institutions have the goal of setting prices at a level that would allow them to make a profit. For-profit institutions often tailor their programs to market conditions and use a "no-frills" approach that allows them to lower their costs. (Many, for example, have limited or virtual campus services such as libraries.)

Role of Title IV Programs

Federal policymakers concerned about escalating college prices frequently focus on the potential role of Title IV federal student aid programs. This also is the area that is most relevant to reauthorization of the HEA. The federal need analysis framework takes the price of attendance into account in calculating the amount of need-based aid for which a student is eligible. For example, eligibility for a subsidized Stafford loan depends on the price of attendance, minus the EFC, minus other aid. Rising prices may drive up the costs of federal student aid programs, if price increases mean the federal government must pay for increasingly large aid awards. At the same time, some policy makers fear that the availability of federal student aid is driving, or at least facilitating, price increases by providing incentives to institutions to "capture" the additional aid dollars. Critics have pointed to the coincidence of increasing aid (especially loans) and increasing prices as evidence of a direct causal relationship. However, the fact of simultaneous increases is not sufficient evidence to enable one to conclude that one type of increase causes the other. Many other factors could be at work.

A direct causal relationship between federal aid and tuition makes sense only if increasing tuition could lead to additional aid dollars for students – i.e., if the resulting increase in calculated financial need allows students to qualify for more aid dollars, without hitting an award maximum or an annual loan limit. Award limits currently exist in Title IV student aid programs; they include the $4,000 maximum Pell Grant award for 2002–03 and the $5,500 annual loan limit for upper-class dependent undergraduate students in the Stafford loan program (see Chapters 3 and 4). Combined with the actual price of attendance, the existence of these limits restricts the extent to which institutions would realize any pay-off for price increases. For example, if the typical price of attendance at a specific college is $6,000 ($2,000 in tuition and $4,000 in other expenses such as room and board) and the maximum aid a particular student at that college can receive under federal programs is $5,000, then raising tuition to $3,000 (thereby increasing the total price to $7,000) will not result in the student obtaining more aid if he or she is already at the $5,000 limit. On the other hand, if the price of attendance is relatively low (whether because of tuition or living expenses), a student may qualify for more aid dollars and there may be an incentive to raise tuition. Thus, the strongest incentives would be created for colleges that charge the lowest prices.

Federal grant aid directly reduces the net price paid by students. It is theoretically possible that colleges raise tuition to capture additional grant dollars; however, there is no clear evidence that this has actually occurred. Some research found evidence of a relationship at public institutions in the early 1980s. Since then, however, increases in tuition levels have meant that for most public colleges, incentives to "capture" grant aid dollars no longer exist, and more recent research has in fact failed to find a relationship. Today, for most students who receive Pell Grants (the largest federal grant program), grants are awarded without consideration of price, because price of attendance generally exceeds the maximum grant award. (As explained in Chapter 3, the award rule used in most cases is the maximum Pell award minus the EFC.)

In the case of federal loans, the possibility of a relationship between increased availability of aid and tuition increases is more complicated. Loans do not reduce the net price to students in the same way as grants do, because loans must be repaid (except for the amount of the loan subsidy). Thus, if a school were to raise its tuition in an effort to qualify more students for loans, the students would bear most of the tuition increases, with loan subsidies relieving only a portion of the additional cost. At the same time, similar to the Pell maximums, the amount of federal loans students can receive is capped by federal loan limits. For example, the limit for a first-year dependent undergraduate in the Stafford program is $2,625 (see Chapter 4). Another aspect of the complex nature of the relationship is that increases in loan volume may reflect student choices about how to fund living expenses (room and board) or whether to attend higher-priced institutions.

Some observers have argued that Title IV loan programs may not directly cause tuition increases, but rather that they enable tuition increases through indirect paths. Colleges may increase tuition, knowing that students can take out loans to pay for it (due to the increased availability of loans), without fear of decreases in enrollment. Another variation focuses on the impact of federal loan subsidies on consumer preferences, i.e., loan terms

and conditions may make college attendance (or attendance at more expensive institutions) seem more affordable. This might lead to increased consumer demand for enrollment, which would drive up prices. This is a classic market demand argument. However, it is important to keep in mind that students and families might take out private loans or use credit cards to pay for these higher college prices if federal loans were not available. In fact, there is some indication that this is occurring for specific groups of students, such as those who are at federal loan maximums. Thus, in today's environment, where loans or other financing vehicles are increasingly available through numerous sources, any impact federal loan subsidies may once have had on consumer demand may have been eroded over time. At the most selective institutions, excess demand is so great that the real question is why prices have not risen even faster than they have.

A final complication is that any potential relationship between federal loans and prices might be tied to a college's use of its institutional aid. Arguments have been made that federal loan aid 1) allows institutions to substitute for their own aid to low-income students, thereby allowing institutions to increase their prices; or, on the other hand, 2) reduces some of the need for institutions to increase tuition in order to award more of their own aid to students (in which case, decreases in federal aid would lead to price increases).

In any case, the evidence regarding a relationship between federal student loans and prices is mixed, with some researchers finding correlations between increases in aid and tuition and others failing to find such correlations. Similarly, some studies have found federal loans to be associated with decreases in institutional aid and others have found increases. The reality may depend on the type of institution, including its governance, resources, student mix, and institutional aid behavior. Overall, it seems clear that even if a relationship between loans and prices exists for some institutions, it is only one piece of the overall tuition-setting picture.

The conclusion is that even if increases in federal aid are correlated with tuition increases, it is difficult to tease out the simultaneous influences of federal aid, increased demand for postsecondary education, and other factors that are equally important, or even more important, to the decision-making process. Many of these factors, for example, state appropriations revenue for public institutions, were discussed in the previous section. Others include the burden of federal regulations, the need for information technologies, the rising costs of deferred maintenance, and the increasing expectations of students for campus services. In fact, studies have found federal aid to have a weak relationship with tuition increases compared with other factors, suggesting that federal student aid is not the primary culprit in explaining tuition increases.

Federal tuition tax credits enacted in recent years, while not Title IV programs, also might have an impact on college prices. In particular, these tax credits provide an incentive for state governments to raise tuition at public institutions or to reduce their expenditures on need-based student financial aid. There is some evidence that states are taking these federal tuition tax credits into account in setting state tuition and aid policies. As with the role of Title IV financial aid programs in setting college prices, this is likely to be only one facet of a complicated decision-making process.

Role of College Costs

In addition to focusing on the role of federal student aid, policymakers often look to increases in college costs (expenditures) to explain rising prices. At most institutions, prices are determined at least partly by costs (such as expenditures on instruction), in the sense that revenues from all sources must cover costs in order to maintain institutional financial health. (At for-profit institutions, revenues must exceed costs in order to produce a profit.) It has been argued that the higher education sector is a labor-intensive industry, with a high percentage of fixed costs and a relatively unchanging educational process. As a result, college costs tend to increase faster than costs in other parts of the economy and the possibilities for cutting costs are limited. It is particularly difficult to effect increases in productivity without reducing the quality of education. For example, a college might increase class sizes and the ratio of students per faculty member in an attempt to improve productivity, but the change might reduce the ability of students to learn the course materials or otherwise degrade the quality of their educational experience. It has also been argued that higher student demands for services offered by colleges – such as access to the Internet, single-room dormitories, and other upgrades – have led to increases in costs above and beyond what would have been necessary to maintain basic educational services.

It is again necessary to underscore that for most not-for-profit institutions, prices are influenced by a number of other factors besides costs. In fact, at most institutions, most types of costs have increased at a lower rate than college prices. Thus, an understanding of costs alone is not a sufficient foundation on which to make informed decisions about prices, and "cost containment" cannot be the only solution to rising prices. Nevertheless, colleges and universities have attempted to respond to concerns about rising "costs" (as well as address their own internal budget considerations) by trimming costs in various areas and attempting to make their cost structures more transparent (see below).

Relevant Provisions of the Higher Education Act

The answer to the question of what factors cause increases in tuition depends on an institution's position within the higher education sector as well as its internal budgetary considerations. It is difficult to find "drivers" of tuition increases that can be generalized to all colleges and universities or to come to a consensus about the appropriate "solutions" to increasing prices.

Few provisions of the HEA directly address the issue of college costs and prices, reflecting the traditional low level of involvement of the federal government in such issues. However, Congressional concerns regarding rising tuitions and the need to make better information available to consumers have prompted several national commissions. The most recent was the creation of the eleven-member National Commission on the Cost of Higher Education, established in 1997 through the Cost of Higher Education Review Act (Public Law 105-18). The Cost Commission (as it was known) conducted an intensive, six-month review of national research as well as its own investigation of trends in costs and prices and potential causes of tuition increases. The Commission's final report to Congress, submitted in the spring of 1998, did not contain any definitive conclusions about the causes of tuition

increases; however, it did propose some promising candidates, including increases in institutional financial aid, student services, administrative expenses, facilities, technology, federal regulations, and changing expectations. Other Commission findings are as follows:

- The Commission found that the language of higher education finance did not clearly distinguish between costs, prices, and subsidies. It expressed the belief that clarification of terms was essential.
- The Commission expressed its concern that college finances had become incomprehensible to the public as well as to institutions themselves, and recommended that a complete analysis of trends in costs over a longer time period be done in order to improve transparency for both the public and the institutions themselves.
- The Commission recommended that colleges take steps to improve their understanding of the relationship between costs and prices and to contain costs where possible.
- The Commission felt that tuition controls would not work and would reduce quality in higher education.

The recommendations of the Cost Commission prompted modifications to the HEA through the 1998 amendments. Thus, Part C of Title I (section 131) of the HEA, "Improvements in Market Information and Public Accountability in Higher Education," tried to build upon the Cost Commission's recommendations through several mandates to the Commissioner of Education Statistics and the Secretary of Education, including the following:

- Improve data collection through the development of a uniform methodology and data definitions;
- Collect information on tuition and fees and average amounts of financial aid received for all institutions participating in Title IV programs and make that information available to the public; and
- Conduct a national study of trends in college costs and prices.

The National Center for Education Statistics (NCES) has made efforts to address the first two elements of the legislation by bringing together experts to discuss data definitions, cost-measurement methodologies, and other aspects of improved data collection. In addition, NCES now collects information on tuition levels, the percentage of students receiving financial aid, and other items of interest for each institution that is eligible to participate in Title IV programs. The information is collected through an Internet-based survey and is available to the general public on the NCES Web site.

NCES is conducting its mandated national study in several phases. In the first phase, it used existing national data and models to examine trends in average costs, revenues, and prices at public and private not-for-profit institutions, to analyze the factors associated with tuition increases, and investigate the potential relationship between various forms of financial aid and prices. The final report on that work was submitted to Congress in early

2002. The first phase of the study largely confirmed previous research on college costs and prices. It failed to find a relationship between federal financial aid and prices; however, the latter was not conclusive due to data limitations and other issues. Work continues on the second phase of the study, which has published an examination of trends in net prices, and will include a look at the concept of marketing bands (peer groups) of institutions and a detailed analysis of instructional costs by discipline.

Meanwhile, individual colleges have made efforts to respond to congressional concerns by publishing information about their costs and prices and attempting to cut costs where possible. In addition, the National Association of College and University Business Officers (NACUBO) initiated a multiyear project to develop a simple, uniform methodology for identifying the costs of delivering undergraduate education in order to enable colleges to explain those costs more clearly to students and families.

Limitations of the Current HEA Provisions

The current provisions of the HEA do not include any measures to control college costs or the prices colleges charge. Any suggestion that the federal government become more active in these areas raises fundamental questions regarding the federal government's role in overseeing higher education finances as well as the practical question of whether effective federal tools to do so even exist.

Historically, the federal role in postsecondary education has not included governance through control of college costs and prices. Private not-for-profit institutions are largely funded by tuition and various forms of private contributions and are governed by private boards of trustees. For-profit institutions may be sole proprietorships or publicly traded entities governed by corporate boards. Public institutions, which enroll more than 80 percent of undergraduates, are governed by state and local government policies through state legislatures, coordinating boards, governing boards, or other entities. State and local appropriations remain the cornerstone of the public higher education financing system. Given this history, initiatives that extend federal financial oversight and control would require a fundamental change in the federal role in higher education – a movement from private self-governance or state control to federal governance.

Even if a federal role in this area were appropriate, there remains the issue of whether the HEA can do anything about price increases. Many proposals for federal interventions, ranging from formal price controls to more indirect incentives, have been debated (see below). Some argue, however, that no effective federal lever exists to control institutional behavior, especially without having unintended consequences for student access and institutional quality.

Beyond the broad concern regarding escalating prices, there is the specific issue of the potential impact of Title IV financial aid on tuition prices. As long as the federal need analysis framework includes some sensitivity to tuition or the total price of attendance, the possibility exists for some direct linkage between federal aid and tuition. For federal student loan eligibility in particular, "financial need" is calculated as the difference between a student's

ability to pay (i.e., his or her EFC) and the price of attendance of the institution he or she wishes to attend (minus other financial assistance). Nevertheless, a basic premise of the federal student aid system is that students should have some level of choice among institutions, and inclusion of the price of attendance in the need analysis is one vehicle for promoting such choice. Thus, even if a relationship does exist, it is not clear that the federal government can do anything about it without reevaluating its role in the higher education financing system and the promotion of educational opportunity for disadvantaged students. The possibility of the federal government addressing an indirect relationship between federal aid and prices (where the relationship occurs through intermediate factors such as colleges' use of institutional aid or shifts in student enrollment demand) would raise even more difficult issues.

Options for Change

If federal policymakers are concerned that Title IV aid programs are not keeping pace with rising prices, they may want to expand student aid to certain groups of students. In effect, this would help students compensate for the rising costs of higher education. On the other hand, policymakers might want to attempt to limit price increases through direct or indirect measures. Several proposals for new federal policy interventions related to college costs and prices are described in the following paragraphs.

Impose direct federal regulation of cost or price. The federal government could place limits on increases in various types of costs. For example, annual increases in faculty salaries could be mandated, or increases in administrative expenses could be tied to increases in instructional expenditures. The federal government also could control the annual growth in tuition levels in reference to an inflation index, family incomes, or some other measure. However, extension of federal regulatory control would face significant obstacles:

- Such limits would require substantial involvement of the federal government either in private markets or in state decision making and oversight. In the case of the latter, this is likely to involve conflict between federal and state roles, requiring some mechanism for resolution.
- These controls would very likely not work in the way they were intended, given the complexity of pricing decisions and the large number of factors involved. In fact, past efforts by some states at price control without attention to market factors have led to cost shifts, rather than reductions.
- The potential effects on access and institutional quality are unknown, but may be quite detrimental. For example, limiting cost or price increases could reduce the number of spaces available at many institutions and thereby restrict student access.
- The potential effects on students' choice of institutions also would likely be detrimental. If higher education costs were uniform, this could damage institutional diversity, a traditional strength of the U.S. system.

Remove price of attendance from the federal need analysis framework. Some states have set up a two-stage process by which they determine students' eligibility for their need-

based grant programs. In the first stage, students are determined to be eligible for funding simply on the basis of their ability to pay (usually using an absolute income cut-off), without regard for the price of the institution they wish to attend. In the second stage, aid awards are made only to income-eligible students, and the amount of the award may take price of attendance into account. The federal government might consider making use of a need analysis formula (most relevant for Stafford loans) similar to the activity that takes place during first stage of the above-mentioned process, i.e., one based exclusively or primarily on students' incomes.

Restructuring the relationship between federal aid and prices becomes an option from two perspectives. If rising prices are perceived to drive up the costs of federal student aid programs, then breaking the links between prices and student aid might help keep down those costs or ensure that aid remains targeted on certain types of students. If federal student aid is believed to be driving or facilitating college price increases, then the focus of the restructuring is to ensure that aid programs provide no incentives for institutions to raise tuitions to capture additional aid dollars. From both perspectives, restructuring the need analysis framework would require a reevaluation of the method and framework of federal student aid, including the goal of college "choice." At the same time, because aid maximums and award limits exist in Title IV aid programs, the links between federal aid and price of attendance already are restricted.

Provide incentives to institutions or states. The federal government could provide financial or other incentives to institutions or states to reduce college costs or improve productivity. For example, federal funding might be provided for pilot projects that explore the effectiveness and efficiency of new learning technologies and reward colleges that implement technologies that have been shown to be useful. (There is some evidence, however, that distance learning is not less expensive than comparable courses in traditional classroom settings; see Chapter 6.) Some have also suggested that federal law could be changed to provide more flexibility to colleges to offer early retirement incentives to tenured faculty. Even not-for-profit colleges should respond to incentives to operate more efficiently.

Many colleges have taken steps to reduce costs on their own. For example, there is a general trend toward substitution of lower-paid, part-time faculty for tenured, full-time faculty. Some colleges have been privatizing specific institutional functions, such as food services and bookstore operations. Other colleges are using differential tuition levels, charging a higher tuition for more expensive programs. If federal policymakers want institutions to reduce costs further, they might consider reducing the federal regulatory burden, which raises the a college's costs of doing business (see Chapter 9). However, given the nature of the higher education sector, opportunities to cut costs may be limited, especially without reducing quality. For example, the trend toward part-time faculty may have a negative effect on the quality of education.

Require better information for consumers. Some of the Cost Commission's recommendations, including more transparency in college costs and the promotion of a more effective marketplace for higher education, have not been implemented. One way to

fully implement these recommendations would be to expand on the information that is available to students and families.

This process has already begun as a result of the provisions of the 1998 HEA amendments. Many institutions have embarked upon voluntary cost analysis, leading to the development of the NACUBO methodology for identifying the costs of undergraduate education. Policymakers could mandate that all colleges use this methodology, but it would be important to weigh the costs of increased administrative burden against the benefits derived from collecting uniform new data. Other options to improve public information include promoting clear definitions and explanations of terms, collecting more data on proprietary schools, and publishing clear information on college prices. NCES has addressed some of these options or is in the process of doing so. As these efforts continue, Congress can play an important oversight role by ensuring the process continues and by seeking explanations for future increases in college tuition levels.

Perform additional research. Finally, a new group could be established to examine the factors contributing to higher tuition prices and to seek ideas for achieving cost efficiencies and reductions. It is unlikely that such a group would learn anything new, especially with regard to the relationship between costs and prices, and certainly not without an expensive and burdensome collection of original data. The debate regarding the appropriate measurement of educational costs also clouds such efforts.

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8

"Do federal spending and regulation produce 'quality' higher education?"

The federal role in accountability for quality in higher education

Background

This chapter discusses the federal government's role in higher education quality assurance, as encompassed in the HEA and carried out by the U.S. Department of Education. It describes how this role has evolved and the multiple approaches to different conceptions of "quality" that have been taken. The chapter begins with a review of the current ED role in quality assurance and an assessment of the issues that are most likely to define the "quality" agenda in the HEA reauthorization. The strengths and weaknesses of the different aspects of the federal role are discussed. The chapter concludes with suggestions about how these factors might influence decisions in the reauthorization debate.

ED's role in quality assurance has expanded over the years, from a historic interest in program administration and financial integrity in the student aid programs, to an interest in broader questions of institutional performance and academic program quality. ED currently has a multifaceted role in quality assurance, by promoting market-based strategies, providing direct regulation of institutions and students, leveraging other nonfederal forms of quality control, conducting research and collecting data. These different aspects of ED's role in quality assurance can be outlined as follows:

- Protection and promotion of market strategies
  - Giving market power to student-consumers through financial aid
  - Providing consumer information to students and employers
  - Ensuring consumer choice among diverse types of institutions
  - Facilitating transfer of credit without mandating terms of transfer
  - Mandating public information such as through Student Right to Know provisions

- Direct regulation of standards or terms of eligibility
  - Financial standards for institutions in the student aid programs
  - Administrative standards for institutions in the aid programs
  - Student eligibility for aid programs (financial need, enrollment status, academic progress)
  - Program eligibility for aid (limits on distance learning, academic calendars)

- Leveraging other processes for quality assurance
  - Regulation of accreditation
  - Requirements for state licensure
  - Facilitation of linkages between K–12 and higher education
  - Performance standards for teacher education

- Data collection and research
  - Common definitions of terms
  - IPEDS (Integrated Postsecondary Education Data System)
  - Raising of policy issues through research via PEDAR (Postsecondary Education Descriptive Analysis Reports) and other studies
  - Facilitation of state and institutional accountability systems through public reports using comparable measures

ED also plays an important role in framing public discussions about many aspects of higher education quality, through public pronouncements and other aspects of the "bully pulpit." The bully pulpit role is not discussed in this chapter, because it is not directly related to the HEA. This chapter also does not address the federal roles in quality assurance beyond ED. The federal government has historically had a partnership with higher education for research, and it seeks to stimulate high-quality research. This role involves a number of agencies (e.g., the National Institutes of Health, the National Science Foundation, the National Aeronautics and Space Administration, the Department of Agriculture, the Department of Defense, the National Endowment for the Arts, and the National Endowment for the Humanities) other than Education. The federal government additionally regulates institutions of higher education through agencies other than ED – in particular in employment, environmental, and health and safety legislation (the Department of Labor, the Office of Equal Employment Opportunity, the Environmental Protection Administration, and the Occupational Safety and Health Administration). Although these influences are not discussed in this paper, the reader should keep in mind that the federal government has many influences on quality in higher education that fall outside the purview of the HEA and therefore outside this chapter.

The Evolving Federal Role

For many years, federal interest in quality assurance was largely confined to oversight of administrative and financial accountability in the student aid programs. This role evolved because of the government's interest in equalizing student access by maintaining college affordability through student aid. Although that interest remains at the center of the federal agenda, the trend since the 1990s has gradually been toward a more direct federal role in influencing public accountability for academic quality and institutional performance. This role is being played out not only through direct regulation of financial

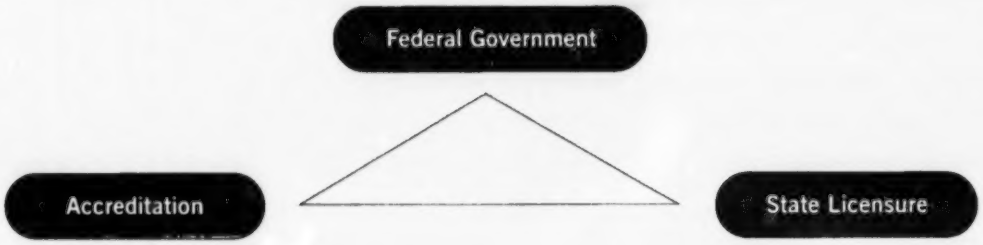
aid programs but also through other accountability strategies such as influences on accreditation and data collection and research. The context of the HEA reauthorization will likely place even greater attention on public accountability as well as on educational quality and effectiveness.

The direct federal role in higher education quality and accountability began with the GI Bill, a program designed to provide vouchers that would help members of the armed forces returning from World War II to attend college. By funding students rather than programs or institutions, the federal government pursued a market-based rather than a regulatory role in quality assurance. Instead of getting into the business of deciding which institutions should be eligible to enroll students in the voucher program, the federal government relied on existing structures for quality by requiring that institutions be accredited by a recognized accrediting agency and licensed to offer higher education by the states where they were located. This system of joining federal administration with state licensure and nongovernmental accreditation evolved into what became known as the "triad" of shared responsibility for quality assurance – a structure that has been maintained, although considerably embellished, over the years (see Figure 1). The legislative provisions of the triad are found in Part H of Title IV of the HEA.

A limited federal role in regulating academic program quality is built into ED's organizing statute. This is in contrast to the role of the national government in most countries in Europe, Asia, and South America, where a national ministry of education directly controls curriculum, degree standards, faculty qualifications, and student admissions. In this country, the states play the stronger role in regulation of public institutions, and there is a large and important private sector, both nonprofit and for-profit. Respect for institutional diversity and autonomy, as well as deference to the reality of a highly decentralized and diverse governance structure, are thus embedded in the U.S. model.

ED is a relatively young federal cabinet-level agency that evolved from a division within the Department of Health, Education and Welfare in 1980, well after the BEOG/Pell Grant and student loan programs were in place. During much of the Department's twenty-year

Figure 1: The Triad of Shared Responsibility for Quality Assurance



history, debate has continued as to whether it should even exist. This is, however, not currently a major issue. ED remains the smallest of the cabinet-level departments, with only 4,600 employees, of whom 3,200 are located in Washington.

The statutory mission of ED is to "ensure equal access and promote educational excellence" in U.S. education (20 U.S.C., Chapter 31, Section 1228 (a)). While the mission to promote educational excellence seems to imply a federal role in quality assurance, the Department of Education Organization Act, which provides the legal authorization for the department, explicitly limits the federal role to one of influence rather than control:

> "No provision of any applicable program shall be construed to authorize any department, agency, officer, or employee of the United States to exercise any direction, supervision, or control over the curriculum, program of instruction, administration, or personnel of any educational institution, school, or school system, or over the selection of library resources, textbooks, or other printed or published instructional materials by any educational institution or school system" (20 U.S.C., Chapter 31, Section 1232).

The federal role in educational policy would appear to be narrowly circumscribed to one of facilitating and financing, rather than standard setting. However, over time the boundaries of that definition have been stretched, particularly in K–12 education but also in higher education. The regulatory reach of the federal government in K–12 education was expanded considerably in the enactment of the "No Child Left Behind" legislation. In higher education, the line between oversight of financial integrity and a direct interest in matters of program quality is difficult to draw. Furthermore, indicators of financial and administrative performance (for example, the student loan default rate) are often treated as surrogates of academic quality. Despite the evolution in practice away from strict adherence to the Department of Education Organization Act, Congress has not repealed the section of the law quoted above. This would seem to indicate that Congress has not abandoned, at least at a rhetorical level, the policy that the federal government should not be directly involved in regulation of program quality.

For many years, the HEA did not delineate specific roles and responsibilities for the different parties in the triad, probably because there was no particular reason to do so and also because of the difficulty in accommodating the many differences among state licensure requirements. For example, many states do not require licensure applications or regular reviews for either public or private nonprofit degree-granting institutions. That changed with the 1992 HEA reauthorization, largely because of problems of fraud and abuse in the federal loan programs, as manifested in rising costs to repay defaulted student loans and in several instances of precipitous school closures that abandoned students in mid-program. The problems were particularly prevalent in the non-degree-granting institutions among the private for-profit vocational institutions, although there were a few cases in regionally accredited degree-granting institutions as well. Instances of mismanagement of funds and abrupt closures in institutions that were fully accredited raised questions about the efficacy

of accreditation and led some to wonder whether accreditors were doing the job to inform consumers about potential problems in institutions.

After considering whether to abandon reliance on accreditation for quality assurance altogether, Congress enacted amendments that increased oversight for all three participants in the triad. Federal administrative, program review, and financial standards were increased; accreditation oversight was also increased; and the State Postsecondary Review Entity (SPRE) program was enacted. SPRE required states to conduct in-depth reviews of the quality of institutions found to be at risk of mismanagement of aid by using a series of data-driven "triggers" such as default rates, patterns of student complaints, lack of timely audits, or low student pass rates on licensing examinations. The statute thus treated technical measures of administrative activity as surrogates for measures of academic quality, with the states deputized as federal agents for purposes of quality review. Both private nonprofit and public institutions argued that this program put the values of institutional diversity and autonomy at risk without any compelling evidence of problems of program quality that would justify such an unprecedented increase in governmental oversight. The SPRE program was politically doomed when several institutions were "triggered" for state review on the basis of inaccurate federal data, calling into question whether ED had the administrative capacity to support more active regulation of institutions.

The extension of federal control into accreditation also generated controversy because it provided the government with the legal vehicle for direct and indirect regulation of previously off-limits matters, such as curriculum, faculty, admissions standards, and tuition charges. It also threatened to transform the historic purpose of accreditation away from peer review and institutional improvement and toward standard setting, regulation, and enforcement.

The threat of a federal takeover of accreditation precipitated a national effort, led by public and private nonprofit college presidents, to strengthen the public policy capacity of accreditation and to create stronger connections between accreditation, institutional improvement, and learning outcomes. A study committee made up of college and university presidents, the National Policy Board on Accreditation, was created to explore ways to create a more effective national capacity for overseeing accreditation. One model that this group explored would have shifted from a regional model for institutional accreditation in the direction of stronger national standards. This proposal was not well received; many institutions did not welcome national standards via self-regulation any more than regulation by the federal government. Thus, efforts within the accreditation community to strengthen the self-regulatory role of accreditation in order to stave off direct regulation by the federal government came to be seen as not much different from other forms of regulation. The decision was made instead to create a national organization for all accreditation agencies. This body is known as the Council for Higher Education Accreditation (CHEA). CHEA emphasizes research, professional development, and accreditation improvement, accompanied by a strong federal governmental relations presence.

The SPRE program was repealed in the 1998 reauthorization. At that time, the federal requirements for accreditation were somewhat rolled back and refined to sharpen the

focus of accreditors on measures of student learning. The change in direction away from either a greater federal regulation of accreditation – or bypassing of it altogether – can be viewed as an indication that confidence in the integrity of accreditation had been somewhat restored. However, in September 2002, Congressman Tom Petri introduced H.R. 5501, the Higher Education Accrediting Agency Responsibility Act of 2002, which would eliminate the requirement that institutions be accredited in order to participate in HEA programs. The introduction of this legislation points to continued skepticism in some quarters of Congress about the value of accreditation from the point of view of assuring educational quality and safeguarding federal student aid funds.

A different set of issues concerning quality assurance emerged in the 1998 HEA reauthorization. These new issues related to the growth of distance learning and to transfer of credit. The issues regarding quality assurance and distance learning are discussed in Chapter 6. The transfer-of-credit issue was raised in response to recurring complaints from students and institutions that credit for courses was being denied when the students transferred to another institution. These complaints were initially directed not to ED but to the Department of Justice (DOJ), where the complainants alleged that enforcement of restrictions on transfer of credit was an illegal restraint of trade under the Sherman Antitrust Act. Two accrediting agencies were targeted by DOJ inquiries – the American Bar Association (ABA) and the Southern Association for Colleges and Schools (SACS), the regional accrediting commission for colleges in southern states. The ABA at the time maintained policies that prohibited institutions seeking ABA accreditation from accepting credits transferred from for-profit institutions. SACS policies were alleged to put a particular burden of review on institutions wishing to accept credits from nationally accredited institutions. DOJ review led to changes in policies in both of these agencies. The changes made it clear that responsibility for decisions about transfer were to be made by the institution on the basis of a review of quality and course comparability; there could be no blanket policies related to the nature of the institution whose credits were being considered for transfer or to the type of accrediting body that the institution used.

At the time of the 1998 reauthorization, representatives of nationally accredited for-profit institutions proposed amendments to the law to require that any credit awarded by an institution accredited by a federally recognized accreditor be accepted for transfer at any other institution. Congress was not prepared to go this far; however, it did ask ED to study the issue of transfer of credit and to determine whether accreditation status was being used inappropriately as a barrier to academic transfer. As of the end of 2002, the Department had not issued a response to the directions in the 1998 HEA reauthorization. CHEA studied the issue and issued a policy advisory to its member institutions and accreditors cautioning them against using either regional or national accreditation status as the sole basis for credit-transfer decisions.

Current Federal Roles

ED carries out a number of roles in quality assurance in higher education (see Figure 2). One of these roles is the direct regulation of institutions on matters of administrative and

financial management via eligibility requirements for federal aid. The Department also exerts an indirect influence on academic program quality through accrediting agencies, data collection, and consumer information. The primary direct regulation is in the administration of Title IV student aid programs. The indirect regulatory influence is much broader, reaching nongovernmental accreditation and the basic terminology and reporting formats for data about higher education. Through the indirect role, the federal government thus has a major role to play in framing the terms of the national discussion about academic program and institutional quality assurance – within institutions, in accrediting agencies, and in states.

Direct regulation. The federal government's regulatory role in quality assurance is centered in its responsibilities for managing federal financial aid programs. Through direct regulation sanctioned by the HEA, ED defines the terms under which students, institutions, and programs may become eligible to receive aid. These requirements ensure that need-based aid goes to students with financial need and the ability to benefit from postsecondary education. These students must be enrolled in financially viable, administratively capable institutions and in programs that meet minimum standards for quality. The students also must be making satisfactory progress toward their degrees or credentials. In addition, since the HEA need analysis methodology is the basis for many state and institutional aid programs, it has ripple effects; states, for instance, may mimic the federal methodology in state aid programs. Other HEA provisions limit aid to institutions and programs relying on distance education, as discussed in Chapter 6. It is important to bear in mind that the original restrictions were written into the law to address possible causes of financial instability and abuse of the student loan programs and to ration limited aid resources, not because they were explicitly linked to measures of academic quality. Once again, these technical requirements have become surrogates for measures of academic quality.

Figure 2: Federal Roles in Quality Assurance

Direct Regulation	*Indirect Influence on Quality*
○ Student eligibility for aid ○ Institutional standards of financial responsibility ○ Institutional administrative standards ○ Recognition of accrediting agencies ○ Requirements for state licensure ○ Requirements for data reporting ○ Requirements for public disclosure of performance (Student Right to Know, Campus Crime provisions) ○ Teacher education accountability reporting	○ Accreditation standards and attention to student learning ○ Definition of terms for data submissions used in accountability reporting ○ Facilitating partnerships with states and others for quality control ○ Protecting and promoting market strategies

Specific examples of HEA provisions that influence dimensions of academic quality are:

- Need analysis for student aid;
- Student enrollment status (full-time/part-time) for determining award levels;
- Standards of student satisfactory academic progress;
- Standards of administrative capability for institutions (records management, audit requirements, staffing requirements in aid offices);
- Definitions of campus location, branch campuses, and off-campus centers;
- Program eligibility requirements, including academic calendars, location, and mode of delivery;
- Definitions of institutions of higher education; and
- Requirements for credit and clock hour attendance and record keeping.

Indirect regulation. Although accreditation began as a voluntary, nongovernmental activity, it is now regulated by ED and is no longer voluntary for institutions that want to offer federal financial aid to their students. Over the past twenty years, the federal government has come to play a larger role in regulation of what had previously been a nongovernmental process for recognizing accrediting agencies. Through a regulatory process that sets criteria for federal "recognition" of accrediting agencies, the federal government sets the standards for deciding which accrediting agencies will be certified as bona fide reviewers of academic quality. There is also a nongovernmental recognition process, managed by CHEA. The CHEA process focuses less on regulatory compliance and more on building capacity, improving accreditation, and helping agencies focus on ways to strengthen review of academic quality. The federal requirements not only affect accrediting agency governance and management but also define the terms for review of academic quality. For instance, all agencies are required to be administratively and financially independent of the institutions they accredit.

Although the regulation of accreditation provides the federal government with a basis for defining the criteria for academic quality review, it stops short of defining the standards on which quality will be determined. Thus, the federal requirements for accrediting agencies set in place conditions and review processes for determining academic quality, but leave it to the individual agencies to define whether the standards for quality of the academic community are being met. The government's role is to define the conditions for a process of quality assessment rather than the specific measures of quality that must be used in that process. The indirect influence on quality via accreditation thus reaches into the internal institutional processes of improvement through ongoing quality review – far beyond the direct influence of the federal recognition process on accrediting agencies.

Federal information, data collection, and research. One of the most far-reaching federal roles in quality assurance is its information collection and research role, which is carried out under the aegis of the National Center for Educational Statistics (NCES). NCES is

What is accreditation?

Accreditation is the external peer review of quality in higher education. It is financed by institutions through dues and charges for accreditation visits. Accrediting agencies review institutions or programs to determine whether they meet standards for quality, judged according to the norms of the academic community and in light of the institution's or program's mission in the following areas:

- success with respect to student achievement as appropriate to mission,
- curricula,
- faculty,
- facilities, equipment and supplies,
- fiscal and administrative capacity as appropriate to the scale of operations,
- student support services,
- recruiting and admissions practices, academic calendars, catalogs, publications, grading and advertising,
- measures of program length and the objectives of the degrees or credentials offered, and
- record of compliance with the institution's Title IV responsibilities.

There are three types of accreditation: 1) *regional* (comprehensive institutional review for degree-granting institutions; called "regional" because the agency authority extends only to a geographic region); 2) *national* (comprehensive institutional review, often for single-purpose institutions, including distance learning, private career colleges, and faith-based institutions), and 3) *specialized* (review of specific programs or schools, such as law, medicine, and teacher education). In addition to publicly certifying that the institution or program meets community standards for quality, accreditation is required for institutions to have access to federal funds. Accreditation status is typically granted for a period of five to seven years, depending on the agency or institution. The accrediting process has five stages: 1) preliminary application and review of eligibility for accreditation; 2) a self-study by the institution using evaluation criteria determined by the accrediting agency; 3) a site visit by a visiting team of peer reviewers; 4) action by the accrediting agency (including opportunities for appeal by the institutions); and 5) ongoing monitoring including submission of periodic reports. The site visit teams are comprised of "peer reviewers," individuals who have gone through accrediting agency training and have academic backgrounds appropriate to the institution or program being reviewed. The federal government oversees accreditation, through a periodic review and "recognition" process for all accreditors seeking to be Title IV gatekeepers. In effect, the federal government accredits the accrediting agencies as capable of carrying out their quality assurance responsibilities.

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authorized under a separate statute from the HEA, but many of the data elements that are the basis for its research are embedded in Title IV requirements. All institutions that want to receive financial aid must agree to complete and submit information in the IPEDS (Integrated Postsecondary Education Data System) formats – a requirement that became mandatory in the 1992 amendments. IPEDS, the core postsecondary education data collection program for NCES, is a system of surveys designed to collect data from all primary providers of postsecondary education in such areas as enrollments, program completions, faculty, staff, finances, and academic libraries. IPEDS includes a data dictionary of standard definitions of terms commonly used in higher education, such as what constitutes an "institution of higher education," a "credit unit," or an "academic year." Collectively, these small technical details play a role in quality assurance, because the federal definitions provide the standard terms for institutions and states.

IPEDS data are collected at the state level for public and some private institutions. In most states, data collection is done through a designated state agency for federal data collection, typically the statewide coordinating board or governing board. IPEDS data definitions and reporting formats have become the gold standard for data in higher education; they are used as the basis for most institutional reporting not just to the federal government but also to institutional governing boards and state legislators. NCES aggregates IPEDS data into institutional types, using Carnegie categories that separate reporting for public, private not-for-profit, and for-profit institutions and also separate reporting according to institutional missions (research, comprehensive, baccalaureate, technical, and vocational). Almost all NCES reports that are generated using IPEDS data exclude the proprietary sector, because NCES is not confident in the reliability of these data.

IPEDS data are also used in statewide accountability reporting, on performance indicators that are defined at the state level. The indirect regulatory influence of IPEDS on capacities for states, accreditors, and others who measure academic quality is vast, but largely unconscious, and it is not explicitly connected to notions of quality or production. Even so, the vocabulary embedded in the data determines the way that higher education activities are defined, and such definitions have historically confined the terms of discussion about quality to those things that can be measured in standard activity terms. As noted, it also tends to confine most reports about quality to the public or private nonprofit sector, leaving aside issues of public accountability and performance in the proprietary sector.

NCES research. ED also plays a role in framing national discussions about quality through its program of research in NCES. NCES maintains an ongoing program of research in the following areas: assessments, early childhood, elementary/secondary, international, library, postsecondary, and references. The postsecondary and assessments areas are most relevant for higher education. The two ongoing national assessments are the National Assessment of Educational Progress (NAEP), which is a survey of student learning, and the National Assessment of Adult Learning (NAAL). NAEP has historically confined surveys of student learning to three snapshots, taken in the third, eighth, and twelfth grades. Not all subject areas are tested in all three areas. NAAL surveys extend to older adults through

surveys of basic adult literacy and numeracy skills. NAAL uses a national sample that is too small to produce state-level statistically reliable measures.

In the postsecondary area, in addition to IPEDS, there are several other data collection projects that conduct periodic national surveys. They are Baccalaureate and Beyond, Beginning Postsecondary Student Longitudinal Study, High School and Beyond, National Education Longitudinal Study of 1988, the National Household Survey, the National Longitudinal Study of the High School Class of 1972, the National Postsecondary Student Aid Study, the National Study of Postsecondary Faculty, the Postsecondary Education Quick Information System, and the Recent College Graduates Study. NCES also commissions some research using NCES data for analysis of key issues, through its PEDAR (Postsecondary Education Descriptive Analysis Reports) series. Some of the PEDAR report topics are generated within NCES, and NCES used the PEDAR reports to respond to the congressional mandate to study trends in higher education prices and costs (see Chapter 7). Some titles of PEDAR reports currently in progress are *Early Attrition from Postsecondary Education (Institutional Differences in Persistence and Reasons for Dropping Out); Teaching with Technology: Use of the Internet and Other Telecommunications Technology by Postsecondary Instructional Faculty and Staff; Minority and Women Faculty and Instructional Staff; Instructional Staff and Faculty who Taught Undergraduates in 1999; Tuition Discounts: Profile and Persistence of Full-Time Beginning Students Who Received Institutional Aid in 1995–96;* and *Community College Outcomes.* The emphasis in these studies – i.e., on issues of student retention and degree production – clearly suggests at least a latent policy agenda on aspects of educational quality.

Student Right to Know and Campus Security provisions. In addition to submitting data for IPEDS surveys, institutions are required to compile statistics and publicly report on different aspects of institutional performance through the "student right to know" and "campus security" provisions of the law. These reports are designed to improve the quality of information available to students and parents about graduation and completion rates and campus crime. This part of the law was initially developed as stand-alone legislation in 1990, a relatively rare example of significant change in the HEA done outside of a reauthorization. The law has two parts – Title I (Student Right to Know) and Title II (Campus Security). Under Student Right to Know, institutions must prepare and report to IPEDS and to the general public on graduation or completion rates of all first-time, full-time undergraduates seeking a degree or certificate. Graduation and completion rates must be reported separately for all students receiving athletic-related aid, by race, gender, and sports program. The Campus Security Act requires public reports on campus crime statistics and security plans (see Chapter 9).

The definitions of student cohorts and measures for student retention and completion set forth in the Student Right to Know Act have become standard measures in higher education. They are embedded in institutional and national accountability reporting systems and are standard features of campus rankings such as those conducted by *U.S. News and World Report.*

K–12 teacher education accountability. The biggest extension of the federal role in higher education quality assurance in the 1998 reauthorization came about as a result of

concern about the quality of teacher education and the role of higher educational institutions in preparing qualified teachers. HEA Title II became the vehicle for an expanded federal role in quality assurance, through mandates of state approaches to public accountability for results in teacher education programs. Each state was required to publish reports on the design and performance of its teacher education programs. These reports had to include descriptions of state requirements for new teachers, along with the results of licensure examinations for graduates from each teacher preparation program in the state. This section of the law provides a potential precedent for future federal roles in higher education quality assurance. The model here combines a number of federal strategies for quality assurance, in particular by leveraging states as partners in quality assurance and through public information strategies for documenting institutional performance. It is important to note, however, that the strategy does not include public reliance on accreditation as part of the federal approach to accountability in teacher education. In sum, the federal government does not quite cross the line as a direct regulator of the quality of teacher education, but it does frame a national approach to teacher education quality assurance, through state partnerships and public accountability strategies, that bypass accreditation altogether. These new requirements are also discussed in Chapter 2.

The Emerging Context for Federal Quality Assurance

In each HEA reauthorization, the major trends of the day shape the legislative agenda that emerges. For instance, concern over fraud and abuse and financial mismanagement within higher education framed the reauthorization of 1992. Rising college tuitions, the expansion of distance learning, and the emergence of nontraditional institutional delivery systems became themes in the 1998 reauthorization. These issues will undoubtedly remain part of the agenda in the next reauthorization. At the same time, three additional issues are likely to shape discussions about quality assurance: 1) the fiscal crisis in the states, 2) new attention to public accountability systems in higher education, and 3) continued momentum from the standards movement in K–12 education.

The fiscal crisis in the states. The recession has created a serious problem in state financing for higher education in almost all states, forcing reductions in budgets and increased tuitions. These cuts in state appropriations are coming at a time when many states are being pushed to expand capacity to serve an expected additional 2.6 million students in higher education nationwide by 2015. Rising public sector tuitions will increase the need for federal grant aid and will put more pressure on states and institutions to increase funding for grant aid. The combination of rising prices and growing demand for admissions has led to changed enrollment patterns in many states: public research universities are capping enrollments and limiting access, pushing more students to comprehensive public and community colleges.

Public accountability models. Public accountability – through rankings, state-based accountability systems, and other reports of learning outcomes – is a hot

topic in higher education. The last few years have seen a huge increase in types of public accountability systems, including public report cards, private rankings of institutions, experiments with new types of institutional assessments, and state-based accountability systems. Almost every state now has some kind of public accountability system that uses data-driven measures to compare institutional performance on different state indicators. These systems tend to be confined to public institutions and typically focus on institutional performance rather than on student or statewide performance. Another model that has come to be part of the landscape is the private rankings, done by outside organizations such as *U.S. News and World Report*, Peterson's, or Kiplinger's. These are designed to allow consumers to compare institutions by ranking the institutions in comparison to one another. The data used for the rankings differ somewhat from survey to survey, but typically are based on resources, student admissions selectivity, and reputation as measured by peer surveys.

Concern about the ubiquity of the rankings services has led to the creation of a number of alternative ways to measure institutional performance. These include surveys of student engagement and alumni interests – the National Survey of Student Engagement and the College Results Index, respectively. A new tool has been developed in the first national state-based report card on higher education, developed by the National Center for Public Policy in Higher Education. Titled *Measuring Up 2000*, the report card compares states on aggregate performance in meeting various public purposes for higher education, such as student academic preparation, access, participation, completion, and social benefits. It differs from the other types of accountability models because the state, rather than the institution, is the unit of analysis.

The momentum from the K–12 standards movement. This movement has been gaining momentum since the publication of *A Nation at Risk* in 1983 and has been propelled in part by collaboration between state governors and the national business community. In the K–12 context, accountability is coming to be understood to be about improvements in student learning, not assessments of institutional activity. The primary features of the K–12 accountability model are 1) learning standards that are the same for all children; 2) school-site assessments of student learning; 3) public accountability for student learning results, including expanding access to results beyond teachers and school boards to include parents and state-level elected officials; and 4) sanctions and rewards for results, including the possibility of state takeover of failing schools. While much of the K–12 standards movement has played out at the state and local levels, it increasingly has moved to the national level, most recently in the enactment of the "No Child Left Behind" legislation, which mandates a greatly expanded federal presence in overseeing state-based student learning assessments. The section of the HEA on teacher education accountability also follows the logic of the K–12 standards through state-based standards and public disclosure of results.

Many aspects of the public discussion about higher education quality and accountability parallel that of K–12, particularly the interest in moving away from measures of institutional activity and toward student learning outcomes as the basis for quality assessment. However, there are important structural and financial differences between K–12 and higher education that will make it difficult to extend the K–12 accountability model to higher education. Most important, the institutional diversity in higher education and the absence of a postsecondary national curriculum that frames the basis for student learning assessments mean that more complicated measures that acknowledge more diverse learning goals will be needed.

HEA Reauthorization and Options for Improving Accountability for Quality

The HEA reauthorization will most likely include consideration of initiatives to use the federal government to improve higher education quality. The administration's agenda for accountability is suggested in the discussion of higher education in ED's Strategic Plan and in the "Notice of Request to Obtain Comments Related to Reauthorization of the Higher Education Act" published in the *Federal Register* on December 20, 2002. The Notice includes among ED's goals for the HEA reauthorization developing proposals to "improve the quality of...postsecondary education, promote greater emphasis on achieving results, improve student achievement, and ensure accountability for taxpayer funds." ED Assistant Secretary for Postsecondary Education Sally Stroup has said that the Department will be interested in using the HEA reauthorization to take a fresh look at accreditation, transfer of credit, and retention and graduation. Senator Joseph Lieberman has expressed a similar interest in accountability. He has said in his agenda of priorities for the HEA reauthorization that the government should apply the "same relentless focus on results" to higher education that it has directed to elementary and secondary education by setting goals that by the year 2020, 90 percent of students who start higher education will finish within six years. He has also called for "plain language report cards" that lay out graduation rates of public colleges and universities, so that "schools can be held accountable by the people and the communities that they serve."

There are many ways that this generalized agenda of greater "accountability" could be played out in the HEA reauthorization. The options include direct regulation of institutional and student eligibility for financial aid by linking eligibility to measures of retention, graduation, and time-to-degree as surrogates for quality and institutional performance in higher education. This could be done either through individual student eligibility (such as conditioning aid on standards of academic progress, enforced through measures of credit hour and enrollment time), through campus-based aid programs that enhance funding for institutions that meet performance standards on retention and graduation, or through institutional eligibility using retention and degree production measures. A shift to funding institutional performance rather than student access and persistence would represent a fundamental change in the historic role of ED – i.e., from funding students to funding institutions. Such incentive programs would inevitably benefit institutions with more selective admissions policies serving full-time students – students much more likely to be middle and upper income rather than poor students, the historic focus of federal financial aid.

Other options might include:

- Leveraging standards through accreditation, such as requiring accrediting agencies to clarify student learning expectations for different degree programs. This would be a move in the direction of national standards for student learning, which would threaten historic respect for institutional diversity and autonomy.
- Differentiating standards for accountability between public, private nonprofit, and proprietary sectors. The law allows for different reporting schedules for institutions based on accounting structures, but otherwise does not recognize different accountability standards between public, private nonprofit, and proprietary institutions. A movement toward greater recognition of the differences between the sectors would move the federal government away from a student-defined, sector-neutral stance, in the direction of institution-specific standards for performance.
- Leveraging market strategies to enhance accountability by increasing public information about student learning. This could be done by investing more federal funds in expanding data on student learning. For example, the sample size in the National Assessment of Adult Learning might be increased so that it could be valid at the state level. The effectiveness of this strategy would rely on the extent to which the states pursue what would be a very differentiated and uneven approach to accountability.
- Increasing quality through expanded competition in higher education. For example, restrictions on distance learning at Title IV-eligible institutions could be removed to increase competition. Such a step would raise concerns about a return to "diploma mills" or other dilutions in quality.
- Setting federal standards for quality by removing accreditation from the triad and defining degree standards in the statute. This could be damaging to institutional diversity and autonomy, would be expensive to implement, and would require a significant increase in administrative and policy capacity in ED. It would also seem to require an explicit revisiting of the statutory restrictions on ED's direct regulation of academic quality.

Trade-offs in Initiatives to Improve Quality

The current multifaceted approach to different dimensions of quality make ED's role in quality assurance a complex and far-reaching enterprise. Multiple strategies are used, anchored in direct regulation through ED, but reaching far beyond ED to leverage many other influences on quality. The approach also blends direct federal regulation and aspects of state regulation, with a heavy reliance on self-regulation, market approaches, and public disclosure. The strength of the model is embedded in its complexity: multiple strategies are used, and resources that go well beyond the reach of the federal government are leveraged.

One weakness of the model is that it is neither explicit nor strategic. The law provides little clarity about the federal purposes in quality assurance or about why the object of

regulation is a dimension of "quality." As a result, it is sometimes hard to tell what results are desired, as there is often a poor match between problem and solution in the federal approach to quality." For instance, regulating academic calendars is at best a clumsy tool for getting either at institutional integrity or improving the quality of student learning.

Moreover, the line between the federal interest in financial and administrative accountability and the regulation of program quality is blurred. This blurring occurs, for example, in the time-based eligibility for student aid as well as in the use of student loan defaults as surrogates for program quality. This presents problems with data collection and reports about performance, since the financial and activity measures that are appropriate for administrative and financial reporting are poor measures of academic quality. These activity reports (such as student retention and degree completion) may end up being used as surrogate measures of student learning, even though they are not. Another weakness is that it is a process-heavy approach to quality assurance in academic programs. These processes may well lead to institutional improvement, but they are not grounded in clear expectations or standards for bottom-line educational performance. The lack of national standards is necessitated by the diversity and decentralized governance structure of American higher education – two features that arguably have made it the finest system in the world. Nonetheless, the process-dependent, diffused approach to quality assurance means that there is often an absence of public clarity about performance expectations – either for quantitative measures of institutional activity or for student learning. This is part of the reason the federal government has historically resisted efforts to set different performance standards between public, private nonprofit, and for-profit institutions.

The specific trade-offs associated with any proposed changes in ED's role in quality assurance will, of course, depend on what is being proposed. However, the following types of considerations will likely come into play:

Political support and opposition. The gradual growth of the federal role in quality assurance has not followed an explicit agenda; instead, it has been an incremental addition of responsibilities designed to solve specific problems, typically defined administratively rather than in terms of academic quality. Moving forward on a more explicit or aggressive federal role in quality assurance is bound to be controversial, because it will challenge time-honored traditions of institutional and state autonomy. The failure of the SPRE program provides a recent example of the results of a federal foray into a more ambitious role in quality assurance. The SPRE program ended up touching only the private nonprofit and for-profit sectors, leaving public institutions, which serve the vast majority of students in this country, alone. There is no current groundswell of public concern about quality in higher education to justify this level of intrusion, making the program politically untenable in the national political environment. Expansion of the federal role in public information and disclosure has been much less controversial. Federal information collection activities have increased significantly in the past decade, and although institutions protest about regulation and paperwork, they clearly prefer expansions in public information and disclosure to direct regulation. An expansion of the federal role in public accountability for higher education could be carried out without

serious political backlashes, particularly if it were crafted to ensure a minimum of new reporting requirements.

Match between problem and solution. Any proposal to change the federal role in quality assurance should match a clearly defined problem with a workable solution. To pursue a general agenda with no particular purpose would only further diffuse already strained federal resources. For instance, if the primary public policy issue is abuse in the management of Title IV funds, then the federal government's solution should aim at Title IV management and not veer off into broader issues of performance or program quality. If the concern is about rising tuitions, the federal government's solution should address the root causes of tuition increases – declining public revenues, and increased spending on institutional aid. Neither of these is likely to be solved through increased reporting requirements. If, on the other hand, the primary issue is degree completion and baccalaureate productivity, then improved public accounting for student degree success is a legitimate strategy. Finally, if measuring educational skills of graduates is the key issue, the federal government could invest resources in new surveys of student learning, with adequate sample sizes to allow state-level measures to be developed.

Implementation feasibility. Any change in the federal role in quality assurance should be designed so that it can be implemented reasonably easily. It should also be capable of being managed within ED's administrative and regulatory capacity or that of designated state partners. The SPRE amendments failed in part because they required a large increase in ED's oversight and regulatory role but were not accompanied by an increase in resources to carry them out. The long and contentious process of implementing the teacher education reporting requirements in Title II were similarly exacerbated by thin research and policy leadership resources within ED. ED has its hands full with the implementation of the "No Child Left Behind" legislation, calling into question its ability to undertake major new regulatory responsibilities.

Incremental rather than wholesale change. Any dramatic increase in the federal role in quality assurance in higher would have to be preceded by a groundswell of public support for such action. In the absence of a clear mandate for change, any expansion (or contraction) in the federal role in quality assurance should probably be incremental, guard against unforeseen consequences, and be capable of being expanded (or contracted) in subsequent reauthorizations. For instance, removing federal requirements for uniform academic calendars could have unforeseen consequences that cause an increase in "diploma mills." Rather than removing all requirements overnight, the government could proceed through controlled experiments that monitor the consequences of change.

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9

"Is higher education needlessly bound in red tape?"

Regulatory burden

Background

Higher education leaders protest "the rising tide of regulation." The National Commission on the Cost of Higher Education identifies regulations as one of the "cost drivers" behind increases in tuition. In general terms, the issue is that the government is requiring institutions of higher education to do things that they believe are inappropriate or unnecessary in relation to the public benefits that result. This chapter addresses the following three questions: Which "government" is the source of the regulatory burden on higher education? Why are some regulations inappropriate or unnecessary? and What role does the HEA have in both causing and remedying the regulatory burden?

First, a word about "regulations." Regulations are rules written and enforced by the executive branch of government to carry out some laws. Every regulation must have a statutory basis, and every regulation must be linked to the law it is designed to put into effect. Since regulations carry out a law, they have the force of law; violating a regulation generally carries with it the same consequences as violating the law from which the regulation derives. Regulations are required to carry out some laws because the goal of the law is too complex, too technical, or too politically difficult for legislators to handle with statutory language alone.

Executive branch regulation writers and enforcers are not blameless in the creation of regulatory burden; however, the problem of regulatory burden is fundamentally a problem of statutory burden. It is the laws that spawn the regulations, and it is through law that perceived regulatory burdens can be alleviated. Therefore, the primary focus for both the cause and the cure of regulatory burden should be the legislative branch, not the executive branch. If there were no laws, there would be no regulations.

Sources of Regulatory Burden

The regulatory burden on higher education is not the product of actions by one government. It arises from many governments and from multiple sources at each level of government, as well as from some nongovernmental entities. The federal government regulates higher education in several different and distinct realms. Among them are student financial aid, including issues such as refund policy, incentive compensation, and lender inducements; civil rights, including issues such as affirmative action in admissions and standards for equitable funding of women's college sports; tax policy, including issues such as unrelated business income and the deductibility of various kinds of donations;

employment policy, including issues such as the collective bargaining rights of faculty and standards of employment discrimination; and research, including issues such as the protection of human subjects and the disposal of hazardous waste. At the federal level, these issues bring higher education institutions into contact with the Department of Education, the Department of Justice, the Internal Revenue Service, the Department of Labor, the National Institutes of Health, the National Science Foundation, the Environmental Protection Agency, and many other government entities. State governments license all institutions of higher education to do business in the state, subject to various conditions, including consumer protection, public health and safety rules, and open meeting and open records laws. States generally subsidize public higher education and play a major role in determining the tuition charges. Local governments usually control zoning and land-use policies, thereby exercising a major influence over what can be built and where. As a service industry engaged in international commerce, higher education is also subject to international fair trade standards. Finally, as a condition of belonging to private voluntary associations such as accrediting bodies or athletic conferences, institutions of higher education agree to be subject to yet other sets of rules. Thus, the regulatory burden on higher education does not emanate from a single government source and therefore does not lend itself to a simple solution.

Standards for Assessing Regulatory Burdens

Focusing on the federal level, institutions of higher education choose to participate in federal programs that support higher education, such as student aid, tax benefits, and research. It is expected that participation in these programs will carry with it reasonable, necessary, and appropriate conditions and controls to ensure that the purposes of the program are achieved. Rules for each program specify who is eligible to receive support; what activities can or must be undertaken; how funds are managed; what data must be gathered about program activities, outcomes, and expenditures; and what evaluations and reports must be provided.

In some cases, the acceptance of federal funds through participation in federal higher education programs triggers other rules that are not directly related to the higher education program. For example, federal civil rights laws prohibit discrimination on the basis of race, color, or national origin (Civil Rights Act of 1964), sex (Title IX of the Education Amendments of 1972), and disability (Section 504 of the Rehabilitation Act of 1973) "under any program or activity receiving federal financial assistance."

The critical question is this: When are the rules no longer reasonable, necessary, and appropriate to achieve the purposes of the federal higher education program or another legitimate federal purpose? Some rules are inappropriate simply because they are ineffective in achieving the federal purpose. It is burdensome to carry out bad program design. For example, monitoring the precise number of contacts guarantors have had with students who have fallen behind in their loan repayments and when those contacts occurred makes much less sense than looking at the bottom-line performance of guarantors in averting or curing defaults.

More important, many rules are criticized for being too costly in relation to the public benefits that the federal program or requirement produces. Those who hold this position believe that federal rules should be subject to a cost-benefit analysis. As reasonable as this might be in theory, the reality is that we have no reliable and practical analytic techniques with which to measure either the regulatory costs or the public benefits of a program. We are left with broad but unsupported indictments asserting that federal programs (or governments generally) impose burdens that are too costly compared with their benefits.

The regulation of colleges and universities also needs to be evaluated from a federalism perspective and a public-versus-private perspective. Which areas of regulation are more appropriately undertaken by state government with respect to public, private nonprofit, and private for-profit institutions? In these areas, federal regulations should not supersede or duplicate those of the states. For example, recently proposed federal legislation requiring sprinklers in college dormitories would seem to usurp the long-established local responsibility for fire safety standards. Had this legislation been adopted, it could have mandated a fire-suppressant technology that is less effective than what is already required in many places. Likewise, it might not be appropriate for the states to regulate in areas where there are well-established federal rules. Moreover, some aspects of higher education, particularly in the case of private nonprofit institutions, probably should be beyond the reach of government regulation. This latter category includes subjects such as the content of courses and judgments about the academic merit of the work of faculty members.

Linking federal program spending to civil rights laws is generally seen as acceptable and appropriate. However, many federal requirements are unrelated to the purposes of the programs to which they are linked. These requirements are often seen as inappropriate. For example, no institution of higher education can receive financial assistance under any federal program unless it implements a drug and alcohol abuse program that is specified in detail in HEA Section 120. Another frequently cited example of an inappropriate regulatory burden is the campus security policy and campus crime statistics requirements (Section 485(f)). These requirements must be met by any institution that wishes to participate in an HEA student aid program, even though they have nothing to do with student aid. These requirements are highly prescriptive and include more legislative language than the Pell Grant program does. In particular, they require gathering large amounts of data on criminal offenses occurring at each institution. The assumption is that prospective students will weigh the relative risk of attending different institutions on the basis on these data, and that institutions competing to attract students will improve their campus security in order to be competitive and attract students. There is no evidence that students factor these data into their choice of an institution or that institutions significantly modify their policies or commitments of resources in response to these data. These requirements, in sum, seem to result in a paper chase that provides no public benefits in return for a substantial cost.

Why do some requirements that are attached to unrelated programs seem acceptable and reasonable (e.g., civil rights) while others do not (e.g., campus crime)? No one in higher education has articulated a principle that makes it possible to distinguish between these two situations. One can only say that the public benefits in the first case seem to exceed

the costs, while in the second case they do not. However, it is unlikely that institutions of higher education would find an acceptable general principle to be: it is acceptable to attach unrelated requirements to a program whenever the public benefits of those requirements exceed their costs.

On some occasions, the exercise of discretion by the executive branch in formulating regulations to implement a law produces a burdensome result. Some regulations depart far from the intent of the underlying statute. When this happens, it is always partly because the legislative branch has failed to express its intent with sufficient clarity. Some regulations are too rigid; they prescribe one size for all and fail to take into account the diversity of the students and institutions of American higher education. Other regulations presume a level of administrative capacity and sophistication that many institutions do not possess. Not every institution of higher education has the administrative systems or resources of a University of Michigan or a Duke. Many community colleges, MSIs, and small private colleges are frequently left baffled and overwhelmed by regulations written without an appreciation for what these institutions can reasonably do in terms of record keeping and data generation. These administrative excesses can be addressed by vigorous legislative oversight or, if that fails to remedy the situation, by corrective legislation.

Options for Dealing with Regulatory Burden in the HEA Reauthorization

As should be clear from this discussion, the HEA is not the primary source of the regulatory burden on institutions of higher education; however, the student financial aid programs have often been singled out as among the major sources of regulatory burden. The HEA reauthorization can make three contributions to the problem of regulatory burden.

First, the amendments to the HEA can modify piecemeal specific legislative provisions of the student financial aid programs that are the source of inappropriate burdens. At the same time, executive branch regulations dealing with these programs that go beyond their statutory mandate or misinterpret the law can be set straight. Organizations such as the National Association of Student Financial Aid Administrators will certainly offer many suggestions for such legislative modifications.

Some of the options for improving the accountability of higher education for quality and for restraining college prices could substantially increase the federal regulatory burden originating from the HEA. These options are discussed in Chapters 7 and 8. Thus, the HEA reauthorization could be the occasion for either a piecemeal increase or decrease in the regulatory burden on higher education. There is perhaps some irony in the fact that some of the members of Congress who are most vocal in decrying the regulatory burdens imposed by the HEA also can be found among those most sympathetic to using the HEA to control quality and prices in higher education.

A second possibility is that the HEA reauthorization could systematically attack the regulatory burden problems created by the HEA. Congressman Howard "Buck" McKeon, the Chairman of the House authorizing subcommittee with jurisdiction over the HEA,

initiated such a process in May 2001. With the support of Congresswoman Patsy Mink, the ranking minority member of the subcommittee, he asked the higher education community to share with him recommendations for changing the law and regulations in areas where they are "out of date" or "more of a burden than they're worth." He called this process "FED UP: Upping the Effectiveness of Our Federal Student Aid Programs." The subcommittee received more than 3,000 responses.

In July 2002, H.R. 4866, the FED UP Higher Education Technical Amendments of 2002, was introduced. As its title suggests, the bill consisted mainly of technical amendments aimed at clarifying current law. It contained only a few minor provisions to reduce regulatory burden. However, even this modest measure was rejected by the House of Representatives on July 16, 2002, largely because of opposition from Democrats who were unhappy with being denied the opportunity to offer amendments.

The Department of Education joined in the FED UP process with more success than the Congress. It promulgated significant regulatory changes, including eliminating the 12-hour rule with respect to academic programs with unconventional schedules, repealing a mandatory packaging requirement for GEAR UP scholarships, and rewriting the treatment of incentive payments to college recruiters. These changes were not achieved without controversy. ED made these changes in the rules over the objections of some in higher education and despite the fact that a consultative process involving the higher education community (negotiated rule making, or "neg-reg") could not reach a consensus. Neg-reg, which did not work in this case, seems to work best when the actual stakeholders are at the table and when real negotiation takes place.

The meager legislative output from the FED UP initiative exposes the myth that there are a significant number of self-evident regulatory burdens that all will agree to eliminate once they are simply pointed out. There are few, if any, such obvious non-controversial targets for deregulation. In fact, most proposals for eliminating regulations are controversial. Those engaged in advancing FED UP legislation decided that they would move ahead only with proposals that were non-controversial, enjoyed bipartisan support, and required no additional spending. These self-imposed rules guaranteed that little could be done.

The FED UP legislative effort is reminiscent of one aspect of the 1992 HEA reauthorization. A proposal in the House-passed bill would have relieved an institution of higher education from a list of student aid regulatory requirements in four areas, provided that the institution could demonstrate high performance on seven indicators of high- quality management of the student aid programs. As discussions in the House-Senate conference proceeded, members raised objections to allowing any institution to be free of several of the suggested requirements. They also urged that the standards of performance be raised. The results were the creation of a very high fence that, if jumped, provided an institution with almost no significant benefits on the other side. The whole idea was dropped.

The FED UP legislative experience and the 1992 HEA reauthorization suggest that significant regulatory relief cannot be achieved legislatively without controversy.

Therefore, either a legislative process needs to be devised to deal with the controversy or the issue of deregulation needs to be moved out of the legislative process for resolution.

The HEA reauthorization will offer a legislative opportunity to deal systematically with the more controversial proposals pulled from the FED UP reservoir. One process for dealing systematically with these proposals would be to advance all the FED UP proposals en bloc. All the ideas in the 3,000 submissions could be drafted into a single omnibus deregulation bill as part of the reauthorization process. This bill could be subject to review and comment by the executive branch and the higher education community and also be the topic of legislative hearings. If there were a consensus to eliminate certain provisions, they would be eliminated. What would remain – a bill reflecting provisions for which there was a supportive consensus and provisions on which there was disagreement – would be marked up in committee. The political process in committee and on the floor would determine the final product, which could be attached to the HEA reauthorization. In short, higher education would get as much deregulation in student aid programs as it could persuade the Congress to enact.

The 1998 HEA reauthorization instructed ED to review all regulations issued under Title IV to determine which ones are "duplicative" or "no longer necessary" (Section 498B). On January 1, 2003, the Department was to deliver a report to Congress that presented the Secretary's findings and recommendations based on this comprehensive review, including "recommendations for legislative changes." This report could be the basis for a systematic effort to reduce the Title IV regulatory burden in the HEA reauthorization. The report has not been delivered.

Another mechanism to systematically attack the regulatory burden presented by the student financial aid programs of the HEA would be to remove deregulation from the legislative process. This could be accomplished by using the military base closing model. The HEA reauthorization could create an independent commission with a mandate to recommend changes in unnecessarily burdensome statutes and regulations by a date certain. The commission, with a reasonable number of members (e.g., twelve to fifteen), would be appointed by the Secretary of Education or by the Secretary and the leadership of each chamber of Congress. The commission's report, in the form of a bill, would have to be accepted or rejected in its entirety by the Congress. Under this approach, Congress would delegate (or abdicate) responsibility for making decisions on how to reduce the regulatory burden to a balanced group of experts.

If the HEA reauthorization were successful in devising a mechanism for systematically addressing the regulatory burdens presented by the HEA, particularly the student financial aid programs, this technique could be a model for dealing with other areas of federal law making that create regulatory burdens in higher education, perhaps including tax policy, research, and civil rights.

A third possibility is that the HEA reauthorization could deal with the broad issue of the total regulatory burden on higher education. An independent study commission could be

created to survey and map the regulatory burden on higher education. It could address questions such as the following: How much of the total regulatory burden originates with the federal government? How much of it comes from other levels of government or from outside of government entirely? What are the merits of different approaches for assessing the costs versus the benefits of federal regulations affecting higher education? What standard should be used to decide when it is appropriate to link regulatory requirements to unrelated programs?

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"Can the HEA respond to new priorities?"

Serving national needs through the Higher Education Act

Background

Helping students who would not otherwise be able to attend higher education overcome barriers to access and retention in higher education, particularly financial barriers, has always been the central focus of the HEA. At the same time, since its enactment in 1965, the HEA also has been the home for many initiatives designed to serve other national needs and priorities relevant to the times. Many of these initiatives are described throughout this volume. For example, Chapter 6 describes the contribution of HEA programs to constructing academic facilities to provide higher education opportunities for the "baby-boom" generation in the 1960s and 1970s. It suggests how the HEA could again be used to expand the capacity of higher education to meet the enrollment pressures of the future. Chapter 6 also notes the HEA programs that respond to the recent growth in the numbers of students with disabilities in higher education. Chapter 2 describes the variety of HEA programs that sought to increase the numbers of K–12 teachers and the quality of the teaching force – programs that have come and gone since 1965.

Other important goals that were once part of the HEA include support for college library resources, technology, and personnel, which was a key element of the Act in 1965; funds for the development of cooperative education programs that provide alternating periods of full-time study and full-time employment, enacted in 1968; and funds for the development of community colleges, passed in 1972. Current HEA programs that serve national needs other than student aid include the international education programs in Title VI, the Fund for the Improvement of Postsecondary Education (FIPSE), graduate education programs, and initiatives to promote public service. These programs are the subject of this chapter.

International Education (Title VI)

Title VI of the National Defense Education Act (NDEA), which was adopted in 1958, directed aid to language and area centers, research and studies, fellowships, and institutes to meet national needs in the Cold War. The need for language training and related programs was spurred by the Soviet Union's launch of *Sputnik* in 1957. NDEA programs were later transferred to the HEA as its Title VI, and they continue today in substantially the same form as they were at the time of their creation nearly a half-century ago. Currently Title VI supports ten programs through competitive discretionary awards, most of which are made to institutions of higher education. These programs aim to develop knowledge, resources, and trained personnel in the fields of language and international

affairs; to stimulate foreign language acquisition and fluency; to enhance the international skills of the business community; and to increase the number of underrepresented minorities in international service. The two best-known Title VI programs are the National Resource Centers (NRC) and the Foreign Language and Areas Studies (FLAS) fellowships, which receive about two-thirds of the Title VI funds. The NRC program provides grants to institutions of higher education for graduate and undergraduate centers that focus on modern foreign languages and global issues, with each center specializing in a particular region and selected issues. The FLAS fellowship program awards funds to colleges and universities to support graduate fellowships in modern foreign languages and area studies.

The 2001 terrorist attacks on the United States, the war on terrorism, and the demonstrable lack of national expertise in critical languages such as Arabic, Farsi, and Pashto and about countries and societies where Islam is the dominant religion have led to an increased interest in Title VI. In FY 2002, the appropriation for Title VI increased by an unprecedented 26 percent to $98.5 million, with the additional funds targeted on languages and studies related to the Middle East and Central and South Asia.

Fund for the Improvement of Postsecondary Education (FIPSE)

Higher education enrollments more than doubled in the 1960s, spurred in part by newly enacted federal need-based student aid programs and civil rights laws. Many of these new students were from social and economic backgrounds less privileged than those of the students who had preceded them. These students were also more racially and ethnically diverse. Thoughtful observers of American higher education, including the Carnegie Commission on Higher Education, saw the need for reform and innovation in higher education to enable it to meet the needs of these new students. This thinking coalesced in a proposal prepared by Daniel Moynihan, special assistant to President Nixon, to create an autonomous National Foundation on Higher Education. The purpose of the Foundation, to be modeled on the National Institutes of Health, would be to fund improvements in higher education. In the 1972 HEA reauthorization, this proposal was transformed into the FIPSE.

While conceptually less grandiose than the Foundation proposal, FIPSE has had an outstanding record in stimulating and supporting innovation, reform, and improvement in higher education. Among the initiatives for which it has provided seed money or venture capital to more effectively reach underserved populations through competitive discretionary grants are:

- The educational travel organization, Elderhostel, which annually offers more than 10,000 programs serving 250,000 older adults;
- Alverno College's performance-based assessment techniques, which examine specific abilities produced by the curriculum as a whole and also focus on older women students;
- Boricua College, which primarily serves Puerto Rican students with a student-centered, career-oriented, bilingual-bicultural program;

- Audrey Cohen College, which targets low-income adults in human service fields with a curriculum that is based on key professional competencies; and
- Projects in medical education, service learning, distance learning, access for the disabled, and internationalization.

The success of FIPSE is due to several factors including:

- An institutional culture focused on improving teaching and learning for underserved groups;
- An openness to innovative approaches that is the result of reliance on ideas from the field, as well as from its fifteen-member national board, in establishing funding priorities and strategies;
- A simplified grant-making process;
- The unique collaboration between FIPSE staff and project directors; and
- An effective dissemination program.

FIPSE's activities, which are authorized by Part B of Title VII, received an appropriation of $31.2 million in FY 2002.

Graduate Education Programs

At a time when the development and expansion of graduate programs was a national priority, the HEA in its earliest years provided extensive support for graduate programs, including funds for constructing facilities, improving faculty qualifications, acquiring research equipment, and improving program administration. The HEA currently provides such broad support for graduate education only to the HBCU graduate or professional institutions specifically named in Title III. (This program is described in Chapter 1.) Graduate institutions generally, however, are eligible for funding through the HEA for specific purposes such as the teacher training activities supported by Title II (see Chapter 2) or the Title VI international education programs noted above.

Graduate and professional students are eligible for financial aid under the FFEL, Direct, and Perkins loan programs and the Federal College Work-Study program; however, these students are not eligible for grant assistance under the Pell Grant or the SEOG programs. In lieu of a program to provide grant assistance generally to graduate and professional students who demonstrate financial need, the HEA has included an assortment of fellowship programs that target particular fields of study, such as the FLAS fellowships noted above. Public service fellowships and fellowships for "advanced study of domestic mining and mineral and mineral fuel conservation, including oil, gas, coal, oil shale, and uranium" are among the targeted HEA fellowship programs that no longer exist.

Currently the HEA contains two additional fellowship programs authorized by Part A of Title VII. The Jacob K. Javits Fellowship Program, with a FY 2002 appropriation of $10

million, provides fellowships for "graduate study in the arts, humanities, and social sciences by students of superior ability selected on the basis of demonstrated achievement, financial need, and exceptional promise." This program is unique in that fellowship recipients are selected by the Department of Education rather than by a university. The second fellowship program is Graduate Assistance in Areas of National Need (GAANN), which received a FY 2002 appropriation of $31 million. In this program, ED makes grants to high-quality academic departments in fields or disciplines of "national need"; the departments then award fellowships to superior students with financial need. The institutions also pledge to seek talented students "from traditionally underrepresented backgrounds, as determined by the Secretary." Thus, the program requires the Secretary to do a little national manpower planning in deciding which fields or disciplines represent "national need" as well as to ascertain what categories currently describe "traditionally underrepresented backgrounds." The current areas of national need chosen by the Secretary include mathematics, physics, engineering, and computer science.

The HEA also includes in Part A of Title VII the Thurgood Marshall Legal Educational Opportunity Program, which received an appropriation of $4 million in FY 2002. The program gives a single grant to the Council on Legal Education Opportunity, which provides information, counseling, academic preparation (including summer institutes), and financial assistance to low-income minority or disadvantaged students to enable them to gain access to and complete law school. In effect, this is a specialized version of the Ronald E. McNair Postbaccalaureate Achievement Program, the TRIO program that provides similar assistance to low-income and first-generation-in-college students preparing for doctoral study (see Chapter 1).

Public Service

Title I of the Higher Education Act in 1965 supported community service programs conducted by institutions of higher education and focused on urban problems. These programs were to be the urban counterpart of the extension and continuing education activities that linked the land-grant colleges to rural and agricultural America during the century following the Civil War. Displaced for a time by other priorities, a commitment to concentrating the efforts of colleges and universities on urban needs was reborn in the Urban Community Service program, Part C of Title VII, which was enacted in 1980. This program provided competitive discretionary grants to consortia of urban institutions, including colleges and universities. Funds were used to undertake a large number of activities "to assist urban communities to meet and address their pressing and severe problems," such as crime, poverty, and underperforming schools. This program has not been funded since FY 1999, when it received an appropriation of $4.6 million.

The HEA has been used in a variety of other ways to encourage public service, including the public service fellowships noted above. Another manifestation of these efforts is the requirement in current law that at least 7 percent of the College Work-Study funds received by an institution of higher education be used to compensate students employed

in community service jobs. First required in the 1992 HEA reauthorization as a 5 percent set-aside, this percentage was increased to 7 percent in the 1998 reauthorization.

This provision is based on two questionable premises. The first is that community service employment was part of the original intent of the College Work-Study program. In fact, College Work-Study was created in 1964 in the Office of Economic Opportunity, the lead agency of the War on Poverty; only later did it become part of the HEA. The central purpose of College Work-Study was to put money in the hands of students from poor families so they could go to college. Requiring colleges and universities to spend a portion of their College Work-Study funds on community service employment undermines this original intent. It is often more difficult for low-income students to travel off campus to community service jobs than to work conveniently on campus. On-campus work also promotes the retention of low-income students by providing a source of integration and attachment to college life. The mandatory set-aside of funds for community service also makes administration of the program more difficult; colleges and universities must search for community service jobs that may not exist nearby in adequate numbers. They must also deal with multiple employers and keep track of student hours and wages, rather than deal with the single college or university employer. For many students from low-income families, these administrative complexities are a barrier to access to jobs and the money they need to go to college.

The second questionable premise is that there is no great interest in or commitment to community service on college campuses today, and that institutions need to be forced to support community service. In fact, students have increasingly engaged in community service in recent years, and this trend has been encouraged and facilitated by their institutions of higher education. For example, ED data from the 1999–2000 school year indicate that about one-third of all students in higher education (more than five million individuals) engaged in community service activities such as tutoring and mentoring children. The set-aside of College Work-Study funds for community service employment appears to be both unnecessary and mischievous.

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Miller, Margaret A. 2002 "The Fund for the Improvement of Postsecondary Education: 30 Years of Making a Difference." *Change* (September/October), pp 4.

Smith, Virginia B. 2002. "FIPSE's Early Years: Seeking Innovation and Change in Higher Education." *Change* (September/October), pp 11–16.

Appendix 1

Attendees at November 7, 2001 Seminar

Jeff Andrade, *U.S. Department of Education*
Jeff Appel, *General Accounting Office*
Leslie Atkinson, *United Negro College Fund*
David Baime, *American Association of Community Colleges*
Ellynne Bannon, *American Association of Community Colleges*
Corye Barbour, *United States Student Association*
Margarita Benitez, *U.S. Department of Education*
William Blakey, *Dean Blakey*
Sarita Brown, *Hispanic Scholarship Fund Institute*
Alisa Cunningham, *Institute for Higher Education Policy*
Suzanne Day, *Harvard University*
Edward Elmendorf, *American Association of State Colleges and Universities*
Brian Fitzgerald, *Advisory Committee on Student Financial Assistance*
Sarah Flanagan, *National Association of Independent Colleges and Universities*
Lawrence Gladieux, *consultant*
Meg Goetz, *American Indian Higher Education Consortium*
Marshall Grigsby, *Grigsby and Associates*
Rachel Hendrickson, *National Education Association*
Maureen Hoyler, *Council for Opportunity in Education*
Brett Lief, *National Council of Higher Education Loan Programs*
Paul Lingenfelter, *State Higher Education Executive Officers*
Maryln McAdam, *McA Enterprises*
Jamie Merisotis, *Institute for Higher Education Policy*
Scott Miller, *Pennsylvania Higher Education Assistance Authority*
Jon Oberg, *U.S. Department of Education*
Gumecindo Salas, *Hispanic Association of Colleges and Universities*
Bea Pace Smith, *National Association for Equal Opportunity in Higher Education*
Pat Smith, *American Association of State Colleges and Universities*
Clayton Spencer, *Harvard University*
Jim Stedman, *Congressional Research Service*
Patricia Sullivan, *Student Loan Servicing Alliance*
Becky Timmons, *American Council on Education*
Charles Treadwell, *New York State Higher Education Services Corporation*
Thomas Weko, *General Accounting Office*
Jane Wellman, *Institute for Higher Education Policy*
Thomas Wolanin, *Institute for Higher Education Policy*
Lawrence Zaglaniczny, *National Association of Student Financial Aid Administrators*

Appendix 2

Attendees at Seminars to Review Draft Chapters

Brenda Albright, *National Postsecondary Education Cooperative*
Jeff Appel, *General Accounting Office*
David Baime, *American Association of Community Colleges*
Ellynne Bannon, *American Association of Community Colleges*
Barbara Benison, *National Council for Community and Education Partnerships*
Margarita Benitez, *U.S. Department of Education*
Nancy Broff, *Career College Association*
Sarita Brown, *Hispanic Scholarship Fund Institute*
Melissa Clinedinst, *Institute for Higher Education Policy*
Kristin Conklin, *National Governors Association*
Winfield Crigler, *Student Loan Servicing Alliance*
Alisa Cunningham, *Institute for Higher Education Policy*
Jerry Davis, *Lumina Foundation for Education*
John Dean, *Washington Partners*
Brian Fitzgerald, *Advisory Committee on Student Financial Assistance*
Sarah Flanagan, *National Association of Independent Colleges and Universities*
Ivan Frishberg, *United States Public Interest Research Group*
Gregory Fusco, *consultant*
Hector Garza, *National Council for Community and Education Partnerships*
Meg Goetz, *American Indian Higher Education Consortium*
Larry Gold, *American Federation of Teachers*
John Hammang, *American Association of State Colleges and Universities*
Phyllis Hooyman, *Hope College*
John Lee, *JBL Associates*
Moira Lenehan-Razzuri, *McA Enterprises*
Brett Lief, *National Council of Higher Education Loan Programs*
Luis Maldonado, *Hispanic Association of Colleges and Universities*
Dallas Martin, *National Association of Student Financial Aid Administrators*
Maryln McAdam, *McA Enterprises*
Jamie Merisotis, *Institute for Higher Education Policy*
Scott Miller, *Pennsylvania Higher Education Assistance Authority*
Arnold Mitchem, *Council for Opportunity in Education*
Terry Muilenberg, *USA Funds*
Ellin Nolan, *Washington Partners*
Jon Oberg, *U.S. Department of Education*
Ron Phipps, *Institute for Higher Education Policy*
Mark Powden, *Education Finance Council*

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Derek Price, *Lumina Foundation for Education*
Christina Redmond, *Institute for Higher Education Policy*
Kate Rube, *United States Public Interest Research Group*
Gumecindo Salas, *Hispanic Association of Colleges and Universities*
Bea Pace Smith, *National Association for Equal Opportunity in Higher Education*
Pat Smith, *American Association of State Colleges and Universities*
Jim Stedman, *Congressional Research Service*
Becky Timmons, *American Council on Education*
Paul Tone, *National Education Loan Network*
Charles Treadwell, *New York State Higher Education Services Corporation*
John Vaughn, *Association of American Universities*
Harrison Wadsworth, *Washington Partners*
Catherine Wegmann, *Institute for Higher Education Policy*
Thomas Weko, *General Accounting Office*
Jane Wellman, *Institute for Higher Education Policy*
Jill Wohlford, *Lumina Foundation for Education*
Thomas Wolanin, *Institute for Higher Education Policy*
Lawrence Zaglaniczny, *National Association of Student Financial Aid Administrators*

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